ATTACHMENT A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	)	WC Docket No. 02-112
	)	
2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules	)	CC Docket No. 00-175

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

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Executive Summary

The initial comments confirm that Bell Operating Company (BOC) and independent local exchange company (ILEC) long distance services should be treated as non-dominant after the sunset of structural separation requirements, regardless of whether BOCs and ILECs offer such services through a separate entity or in an integrated manner. Arguments to the contrary are nothing more than attempts to hamper a set of competitors that are providing services customers want at prices they find attractive. Our competitors claim they seek to protect competition, but in reality, they seek to protect themselves from the rigors of competition and to keep consumers from obtaining the best possible services at the best possible prices.

Dominant carrier regulation of BOC and ILEC long distance services can be imposed only if the BOCs and ILECs have, or are likely to obtain in the near future, market power (the ability profitably to raise and sustain prices above competitive levels) in ***long distance services***. Allegations that BOCs and ILECs have market power in ***local exchange or access services***, even if true, are plainly legally insufficient.

No commenter seriously argues that, under the criteria the Commission has traditionally applied, BOCs or ILECs have market power in long distance services now. According to the Commission's most recent report, AT&T retains a larger share in wireline long distance services than all of the BOCs combined. If AT&T's share is not sufficient to convey market power, then no BOC share can be either. No commenter disputes that supply and demand elasticities are high. Nor is there

any serious argument that BOCs and ILECs have such enormous resources or other assets to preclude effective functioning of the marketplace.

Arguments that dominant carrier regulation or some other regulatory burdens should be imposed on BOC and ILEC long distance services are based on the faulty premise that BOCs and ILECs can, and are likely to, use their local exchange and access facilities to obtain market power in long distance services. This will be done, they allege, by predatory price squeezes, non-price discrimination, and cost shifting.

These arguments are flat wrong. As the Commission has recognized repeatedly, predation (whether in the form of a predatory price squeeze or otherwise) is extremely unlikely, particularly in long distance services. Major long distance carriers are simply too well entrenched, and there are simply too many long distance facilities in the marketplace to allow any firm to obtain market power through predation. Indeed, this conclusion is more true today than in the past (and will likely be even more true in the future) because of growing intermodal competition from wireless, cable telephony, VoIP, and other Internet applications (e-mail and instant messaging).

As the Commission has previously stated, the possibility of non-price discrimination does not justify the imposition of dominant carrier regulation unless such discrimination is likely to lead to market power. Advocates of dominant carrier regulation never explain how BOCs and ILECs could possibly engage in discrimination that is both noticeable and rampant enough to cause mortal harm to

all other significant providers of long distance services, and clandestine and quick enough to avoid detection by sophisticated competitors and regulators. Similarly, with respect to alleged cost shifting, advocates of additional regulation never explain why cost-shifting is likely to occur, or why it would have an anti-competitive effect, given that the rates BOCs and other large ILECs charge are based on price caps, not costs. In reality, they seek only to deny consumers the benefits of efficiencies that can be obtained (by BOCs and others) through integrating local and long distance services.

Competitors seek to raise a variety of other issues to divert attention from these plain facts. They argue, for example, that BOCs' offering of local and long distance bundles somehow increases their market power in long distance services, but they totally ignore the significant competition that exists both in bundled services and in stand-alone services. And they do not even attempt to explain how wireline bundles of local and long distance services would be likely to eliminate competition from VoIP, cable-based, and wireless bundles.

Finally, advocates of regulation fail to explain how dominant carrier regulation would address the problems they allege will occur after structural separation requirements sunset. There is a simple reason. There is simply no connection between the purposes of dominant carrier regulation and the problems they allege will occur. Dominant carrier regulation is aimed at assuring that prices for telecommunications services are not too high and that customers are not stranded. Regulatory advocates here are concerned that BOC long distance prices

will be too low and that, rather than strand customers, BOCs and ILECs will somehow get them all.

Thus, there is no basis for imposing dominant carrier regulation or any other regulatory burdens on BOC or ILEC long distance services. To do so would harm consumers both now and in the future.

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REPLY COMMENTS OF SBC COMMUNICATIONS INC.

I. Introduction

The only issue in this proceeding is whether eliminating the Section 272 structural separation requirements will result in Bell Operating Company (BOC) or independent local exchange carrier (ILEC) long distance operations gaining "market power" – the ability to raise and sustain prices above competitive levels – such that they should be classified as "dominant" and subject to rate regulation. The issue here is ***not***, as some of commenters suggest, about ***local*** exchange or exchange access facilities. Nor is the issue about leveraging market power in local or access services into long distance. Nor, as AT&T and others suggest, is it whether the BOCs or ILECs have economies of scope that they could bring to bear in long distance.

There can be no serious argument that BOCs or ILECs have market power in long distance services today. Indeed, since BOCs started providing interLATA services as permitted by the Telecommunications Act of 1996, long distance services

have become fiercely competitive. As a result, consumers, particularly those who were unable to take advantage of the targeted pricing plans offered by the Big 3 incumbent long distance carriers, are reaping the benefits through plummeting prices and a variety of package offerings not previously available. No commenter offers any evidence to the contrary.

Equally important, it is clear that no carrier, BOC or otherwise, can readily acquire market power in long distance services. BOC competitors serve up their usual litany of allegations in an effort to show otherwise, but their arguments are largely incoherent and wildly exaggerated.

For example, they claim that BOCs could leverage above-cost access charges to create a price squeeze. But their claims are economically illogical, self-contradictory, and spurious. They ignore the fact that a price squeeze is plainly illogical because BOCs or ILECs could never recoup their investment in low long distance prices. Their discussion of special access pricing is particularly incomplete and misleading. Among other things, it ignores the fundamental point that special access is relevant only to larger businesses, a market segment AT&T continues to dominate.[1]

BOC competitors also claim that BOCs or ILECs could acquire market power in long distance through non-price discrimination in local or access services. Yet,

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[1] R. Krause, "Bernard Faces New Round of Challenges," Investors Business Daily Online (www.investors.com) (July 21, 2003)("Ma Bell still dominates the corporate market for telecom services.")

rhetoric aside, they never even attempt to explain how such conduct could be obvious to consumers and widespread enough to be effective and at the same time undetectable to competitors and regulators. They also fail to explain how a BOC or ILEC could eliminate both intramodal and intermodal providers of long distance services, much less do so in a manner that would avoid regulatory and potential antitrust sanctions.

Our competitors point out that, following initial entry into the market, BOCs gained significant share in a short period of time. They ignore, however, the facts that (1) initial market share gains have generally flattened out over time; (2) those gains were largely attributable to residential consumers (especially those that did not qualify for the incumbent long-distance carriers' own pricing plans); and (3) BOCs still have a lower share than AT&T.[2] They also ignore the glut of long-distance facilities in the ground today, the rapid growth of intermodal competition, and the changes on the horizon (such as VoIP) that promise much more intermodal competition.[3]

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[2] *See* FCC, Statistics of the Long Distance Industry, Table 17 (May 2003).

[3] AT&T itself has, when it was in its own interest to so argue, recognized that:

> "the fixed and variable cost relationships from the massive fiber optic investments of all major participants, and the fact that a fiber optic network cannot be withdrawn and turned to other uses would make it blatantly irrational for any firm to cut prices below incremental costs in the hope of forcing surrender and then recouping losses. Such cuts would have to be *massive and remarkably prolonged* to drive any otherwise viable competitor out of the market."

(continued…)

Remarkably, AT&T claims that dominant carrier regulation is not burdensome. The Commission, of course, has found that such regulation places untoward burdens on the regulated, the regulators, and, most importantly, the competitive process. That AT&T would even make such a claim speaks volumes about its credibility in this proceeding. When its own regulatory status was at issue, AT&T had very different things to say about the burdens of dominant carrier regulation. Then it said:

> [S]uch regulation imposes "barriers and burdens [that] impair competition by delaying or deterring carriers in their service and rate offerings and causing them to bear additional costs," as the Commission has found. . . . [D]irect economic regulation is not merely unnecessary; it impedes the "dynamism" of a competitive market and "impose[s] both direct and indirect costs on users."[4]

AT&T's about-face on this issue should be seen for what it is: a transparent attempt to abuse the regulatory process to gain improper marketplace advantages.

In the final analysis, therefore, the arguments of AT&T and others ring hollow. To them, dominant carrier regulation of BOC and ILEC long distance operations is not about protecting competition; it is about protecting competitors. It is not about preventing supracompetitive pricing; it is about shielding their own

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AT&T Opposition to Ameritech's Motions for Permanent and Temporary Waivers from the Interexchange Restrictions of the Decree, Civil Action No. 82-0192, Affidavit of Lawrence A. Sullivan, App. C at 14-15, Feb. 15, 1994 (emphasis added).

4 *In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Motion for Reclassification of American Telephone & Telegraph Co. as a (continued…)

businesses from the pressures of price competition. And it all hinges on sheer speculation that somehow, some way, the BOCs will be able to slip an elephant into the room while nobody notices – that they will be able to engage in rampant discrimination and/or the type of predatory pricing behavior that courts and economists have long dismissed as improbable, and that they will do so quickly and without detection. These allegations are not only implausible, but utterly baseless; they should be summarily rejected.

II. The Comments Confirm BOCs and ILECs Do Not Have Market Power in Long Distance Services.

Whether a carrier's service offering should be regulated as dominant is determined by whether the carrier has market power in that service. Market power, for this purpose, is defined as "the ability unilaterally to raise and maintain price above competitive levels without driving away so many customers as to make the increase unprofitable . . . ."[5] As will be shown below, the comments confirm that BOCs and ILECs do not have market power in long distance services, based on the

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Non-Dominant Carrier, at 16-17 (filed Sept. 22, 1993) ("*AT&T Nondominance Proceeding*").

5 *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations*, Fourth Report and Order, 95 FCC 2d 554, 558 (1983); *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket Nos. 96-149 & 96-61, Second Report and Order in CC Docket 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd. 15,756, 15,804, ¶ 85 (1997) ("*LEC Classification Order*"), *recon.*, Second Order on Reconsideration and Memorandum Opinion and Order, 14 FCC Rcd. 10,771 ¶ 8 (1999) ("*Second Reconsideration Order*").

traditional criteria used by the Commission. Indeed, by all measures, long distance services are more competitive now than they have ever been. Allegations that somehow the offering of bundles of local, long distance, and other services changes that analysis are unsupported and illogical.

A. BOCs Do Not Have Market Power in Long Distance Services Using the Criteria Traditionally Applied by the Commission.

No commenter seriously disputes the fact that BOCs and ILECs do not have market power in long distance services using the criteria the Commission has long applied to make such determinations. Their share is insufficient; both supply and demand elasticities are too great; and BOCs and ILECs do not have resources that preclude effective functioning of the market in which long distance services are offered.

Market Share. BOCs and other ILECs do not have a share in long distance services that eliminates viable competition from other sources. As demonstrated in our opening comments – and not disputed by anyone – BOCs have a much lower share, even within their regions, than AT&T did when the Commission declared it non-dominant in domestic interstate long distance services.[6] By accepted measures (such as HHI), the marketplace for long distance services – even when only wireline carriers are included – is far less concentrated today than it was when AT&T was

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[6] SBC Comments at 24-28; Carlton/Sider/Shampine Decl. at ¶¶ 20-26.

found non-dominant.[7] These facts alone demonstrate that BOCs' shares are not sufficient to suggest market power in long distance services.

Notwithstanding these incontrovertible facts, some commenters argue that BOCs' share gains have been so rapid that they must have market power.[8] These arguments are flawed for several reasons.

First, as the Commission has recognized, even a high market share does not establish that a market participant has "market power" – the ability profitably to raise and sustain prices above a competitive level. More specifically, a high market share is not indicative of market power when there also are high supply and demand elasticities, as is the case in long distance services.[9]

Second, as set forth in our initial comments, AT&T itself and other market observers have recognized that BOC market share gains are fastest in initial years, and then slow significantly.[10] AT&T's arguments here that initial growth rates are indicative of market power are clearly disingenuous, as are its comparisons to the

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7 SBC Comments at 24-25; Carlton/Sider/Shampine Decl. at ¶ 18.

8 *See, e.g.,* AT&T Comments at 4-5.

9 *See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing Usage of the Public Switched Network by Information Service and Internet Access Providers*, 11 FCC Rcd., 21,354, 21,425 ¶ 158 (1997) ("A company that enjoys a very high market share will be constrained from raising its prices above cost if the market is characterized by high supply and demand elasticities at prices even slightly above competitive levels."). *See also AT&T Nondominance Proceeding*, Reply Comments of American Telephone & Telegraph Co., at 16 (filed Dec. 3, 1993).

10 *See* SBC Comments at 25.

experience of what were then fledgling companies that entered the long-distance market immediately after divestiture.[11]

Third, arguments that BOCs' long distance shares establish market power ignore intermodal competition. As set forth in our opening comments, each of the major long distance carriers has told the investment community that it is losing share to wireless and other modes of communication.[12] Market analysts have come to the same conclusion.[13] For AT&T and others to pretend that those other modes of communication do not constrain the pricing of BOC long distance services is hypocritically myopic.

Supply Elasticity. No commenter even alleges that supply elasticity is not sufficient to prevent the exercise of market power. All agree that there is an abundance of interexchange transport. As demonstrated in the initial declaration of Drs. Carlton, Sider, and Shampine, both the amount of fiber and the sophistication of the electronics employed with it have resulted in a glut of capacity.[14] Moreover,

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11 Indeed, AT&T ignores mention of the fact that the BOCs' initial market share gains in long distance are comparable to those of cable operators as they roll out cable telephony.

12 SBC Comments at 18-19.

13 Carlton/Sider/Shampine Decl. at ¶¶ 28-29.

14 *Id.* at ¶¶ 38-39. AT&T seeks to distinguish prior Commission holdings on this point by alleging that interstate facilities are now a minor cost in providing long distance services, and that access costs are far more significant. AT&T Comments at 64. Its efforts are unavailing.

First, they are contradicted by the words of its own President just last week. She claims that AT&T has "a significant advantage against any of the Bells"

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even those who seek to hamper competition from BOCs recognize that BOCs and other ILECs generally do not have control of any of those interLATA facilities and resell services using the capacity of others.[15]

Demand Elasticity. Similarly, no one alleges that demand elasticity is not sufficient to prevent the exercise of market power. No evidence has been submitted that would support a conclusion that business and residential consumers are any less price-sensitive or any less ready, willing, and able to change providers today than they have been in the past.

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because the Bells "don't have the assets, the networks, the services." According to Bernard, "[i]t takes *decades* to build that capability." R, Krause, "Bernard Faces New Round of Challenges," Investors Business Daily Online, (www.investors.com) (July 21, 2003) (emphasis added).

Second, while the cost of transport capacity undoubtedly has fallen in the past five years (a point AT&T ignores when arguing that CLECs are impaired without access everywhere to BOC and ILEC interoffice transport), so too have access charges. AT&T makes no effort to show that, as a percentage of overall costs, access costs have risen at all.

Finally, AT&T ignores the point, as set forth in the Reply Declaration of Drs. Carlton, Sider and Shampine, that economically BOCs and ILECs incur the same access costs as other long distance carriers. (Carlton/Sider/Shampine Reply Decl. at ¶¶ 6-8.) Moreover, BOCs are required by statute to impute to themselves the access charges they assess other long distance providers. 47 U.S.C. § 272(e)(3). Thus, access charges may be a larger amount, but they are not economically different for the different long distance carriers.

15 MCI Comments at 6. AT&T speculates that when Section 272 sunsets, the BOCs will be able to use their official services networks to provide long distance services. That claim is absurd because those networks do not have even close to enough capacity to serve large numbers of end users. But, even if that were true, no BOC has a pervasive official network outside its region. AT&T and the other facilities-based long distance companies, in contrast, have global networks that dwarf, both in capacity and reach, any networks the BOCs might have.

Indeed, the arguments made in support of dominant carrier regulation are premised on high demand elasticity. Allegations that BOCs have the incentive and ability to engage in a price squeeze or cross-subsidization inherently assume that competing long distance carriers would have to match lower BOC long distance prices if they are to retain their customers. Similarly, arguments that BOCs can compete unfairly by engaging in non-price discrimination inherently assume that barriers to switching providers are low.

Resources and Size. No one alleges that BOCs have control of ***interexchange*** assets that provide them with the ability to preclude the effective functioning of the market. Instead, various long distance carriers erroneously contend that BOC and ILEC ownership of ***local or exchange access*** facilities will permit them to engage in price squeezes, cost shifting, or various forms of non-price discrimination. AT&T goes even further, arguing that BOCs' control of their local exchange networks inevitably means that all downstream markets are non-competitive.[16] SBC shows in Section III below that allegations relating to price squeezes, cost shifting, and non-price discrimination are without merit. In this section, we address AT&T's even more preposterous claim that all downstream markets must necessarily be non-competitive.

The short answer to AT&T's claim is that it is not only demonstrably false but so plainly so that it demonstrates the overblown nature of all of AT&T's

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[16] AT&T Comments at 22-23.

allegations. One need look no further than dial-up Internet access service, which is downstream from local exchange service. BOCs never became major players in that business, despite multi-million dollar efforts.[17] The same is true for customer premises equipment and other goods and services as well.[18]

One reason AT&T's claim is plainly wrong is that it ignores the many competitive advantages it and others have in downstream markets. Those advantages include ubiquitous national and international networks, and established customer relationships nationwide and even worldwide. They also include brands that are among the most recognized nationwide. While AT&T attempts to downplay those advantages in this proceeding, its claims are disingenuous at best. As noted above, AT&T President Betsy Bernard recently said, "We have a significant advantage against any of the Bells. . . . They don't have the assets, the networks, the services. It takes decades to build that capability." [19] And, of course, the ability to obtain elements of the local network at below-cost rates is a competitive advantage, as is the absence of a slew of costly regulatory obligations that are imposed only on BOCs and ILECs. These include, but are by no means limited to, carrier of last resort obligations that require BOCs and ILECs to provide service to customers that are not economical to serve and no one else wants.

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17 SBC, for example, spent tens of millions of dollars to purchase a controlling interest in dial-up Internet service provider Prodigy.

18 Carlton/Sider/Shampine Reply Decl. at ¶ 51.

AT&T, other long distance carriers, and CLECs are not burdened by such requirements and, consequently, can and do focus their marketing on the most lucrative customers.

B. The Emergence of Bundled Service Offerings Does Not Give BOCs Market Power in Long Distance Services.

Several commenters have argued that the emergence of bundled service offerings gives BOCs (or demonstrates that they already have) market power. Americatel, for example, contends that bundling different services together and charging a single price is "the hallmark of a monopolistic market."[20] In fact, quite the opposite is true. Bundles exist in many competitive marketplaces (*e.g.,* travel services). Indeed, WorldCom acknowledges that bundled service offerings are in response to consumer demands,[21] and Sage notes that CLECs, not BOCs, were the

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19 R. Krause, "Bernard Faces New Round of Challenges," Investors Business Daily Online (www.investors.com) (July 21, 2003).

20 Americatel Comments at 23.

21 There is no merit to the suggestion (from Sage) that the Commission should look at a separate wireline local and long distance "bundled" service market. Among other things, as long as local and long distance can be purchased separately without disproportionate transaction or other costs, the prices of the separate items of the bundle constrain the prices BOCs and others can charge for the bundles. Carlton/Sider/Shampine Reply Decl. at ¶ 32.

Americatel argues that firms offering consumers bundles should be required to offer the elements of the bundle separately as well. There is no economic justification for requiring a firm that lacks market power in a particular service to offer that service on a stand-alone basis. In any event, SBC (and, we understand, other BOCs) offer both interLATA and local exchange service on a stand-alone basis. The FCC has stated that the existence of a stand-alone local exchange service offer is sufficient to prevent a BOC or other ILEC from leveraging any alleged market power in local exchange services into another product or service market. *See 1998 Biennial Regulatory Review – Review of Customer Premises Equipment And Enhanced Services*

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first to offer bundle of local and long distance services.[22]

Ad Hoc Telecommunications Users Committee (and its consultants, ETI) contend that BOCs have been able to dictate both pricing levels and the scope of services offered by long distance competitors, a "classic indicator of market power."[23] Yet, the sole support for that proposition is that Verizon quickly obtained a 20% market share (less than ETI's client AT&T) in Massachusetts. Ad Hoc and ETI offer no information about pricing levels and the scope of competitors' service offerings. The only inference that can be drawn is that new competition from Verizon has been good for consumers as it has lowered prices, provided them with

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Unbundling Rules In the Interexchange, Exchange Access And Local Exchange Markets, 16 FCC Rcd. 7418, 7440-41¶ 37 (2001).

Americatel also suggests that the Commission should declare that State Commissions have the authority to regulate the terms and conditions of any bundled service rate offered by a BOC, including the interstate and international services included in the bundle, and even have the authority to prohibit the BOC from offering such services (again including interstate and international services) unless each element of the bundle is available for resale. Americatel Comments at 32-33. Implementation of this suggestion would violate several sections of the Communications Act, including Section 254(g), which prohibits any provider of interstate interexchange services from charging different interstate rates in different states.

22 Sage Comments at 7.

23 *See Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, 14 FCC Rcd. 14,712, ¶¶ 212, 231-35 (1999) ("*Ameritech/SBC Order*"). *See also Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, 12 FCC Rcd. 19,985, 20,045, ¶ 117 (1997) ("*NYNEX/Bell Atlantic Order*"); *LEC Classification Order*, ¶ 129.

new service options, and that other competitors are responding. That is the way competition is supposed to work.

Indeed, to subject BOCs to dominant carrier regulation in the provision of bundled services, as these commenters suggest, would be contrary to Congressional intent. The legislative history of the Act is clear that: (1) bundling of services is a critical marketing tool; and (2) there consequently must be "parity among competing industry sectors" in the rules that apply.[24] Thus, Congress clearly intended that BOCs, once they received Section 271 authority, would be able to bundle local and long distance services without restrictions, just like their competitors.

III. The Elimination of Structural Separation Requirements Will Not Enable BOCs Readily To Acquire Market Power In Long Distance Services.

While most commenters do not contend that application of the factors discussed above lead to the conclusion that BOCs have market power in long distance services, several argue that BOCs will acquire market power once structural separation requirements are eliminated. They argue, in particular, that: (A) BOCs have market power in local and access services; (B) BOCs can leverage that market power to effect a predatory price squeeze; (C) BOCs can engage in non-price discrimination; and (D) BOCs can shift costs or otherwise improperly cross-subsidize their long-distance offering.

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[24] S. Conf. Rep. No. 104-230 at 23.

These claims are specious. There is significantly more competition in local and access services than competitors acknowledge. Moreover, BOC and ILEC local and access service rates are subject to federal (and state) regulation. Price squeeze claims are economically illogical and erroneously assume, contrary to many prior findings by the Commission, that BOCs could cause not only other significant providers of long distance services, but all of the fiber capacity to disappear virtually overnight. Claims that BOCs can achieve market power through non-price discrimination are based on the obviously flawed premise that discrimination will be obvious enough to consumers to make them switch long distance providers yet hidden enough to avoid detection by the BOCs' many sophisticated competitors and federal and state regulators. And arguments that cross-subsidization through cost shifting poses a clear and present danger to long distance competition ignore the fact that BOC local exchange rates (and access rates) are not a function of costs (rather they are subject to price caps), and thus cost allocation is irrelevant for these purposes.[25]

These arguments also ignore that cost shifting that does not result in predation cannot harm long distance competition, and predation, for reasons

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[25] Because all of these arguments are specious, there is no merit to AT&T's contention that international treaty obligations require the imposition of dominant carrier regulation on BOC and ILEC long distance services. AT&T Comments at 53-56. According to AT&T, the WTO treaty obligates the U.S. to maintain adequate measures to prevent anti-competitive practices. Of course, the U.S. already has many such measures, including federal

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discussed in SBC's initial comments and this reply, is not a realistic possibility. Finally, they ignore that, if predation were feasible, it could occur irrespective of any opportunity to shift costs.[26] Thus, even assuming *arguendo,* and against all logic, that the elimination of structural separation raised the risk of cost shifting, it would not create any increased risk of predatory pricing.

A. BOCs Do Not Have Market Power in the Provision of Access Services That Can Be Used To Obtain Market Power in Long Distance Services.

AT&T and others claim that BOCs continue to possess market power in the provision of access services that can be used to obtain market power in the provision of long distance services. Among other things, the predicate of this claim is wrong for at least two reasons. First, it fails to take into account growing intramodal and intermodal competition in local and access services, not to mention the availability to CLECs of UNEs at rock-bottom rates. Second, it ignores the fact that, except in areas where the BOCs have obtained limited pricing flexibility based on objective, competitive criteria, access rates are regulated, both at the state and federal level. Even if, absent regulation, BOCs would be able to charge supracompetitive prices for certain access services, rate caps prevent them from doing so.

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regulation and the antitrust laws, and dominant carrier regulation of BOC long distance offerings is not necessary.

[26] Predatory pricing requires a temporary "investment" in lower prices based on the belief of the predator that this investment will be recouped later, after the elimination of competition. As a theoretical matter, this investment in lower prices can be financed either by outside sources or by drawing on revenues from other services. Carlton/Sider/Shampine Decl. at ¶¶ 61-62.

1. BOC Competitors Understate the Extent of Local and Access Competition.

Citing Commission statements made prior to the opening of local markets pursuant to the 1996 Act, AT&T contends that BOCs maintain "bottleneck control" of local exchange and access facilities.[27] AT&T alleges that ILECs directly or indirectly (though CLECs' purchase of resold services or UNEs) serve over 96% of switched access lines, and that even in the most competitive local markets, BOCs are the only carriers providing access services to most buildings.[28] It claims that the local BOC is the only facilities-based option for special access in 85-95% of the buildings in many major cities.[29]

These data, however, greatly understate both the extent and significance of competition in local and access services. As explained in the *UNE Fact Report* in the *Triennial Review* proceeding, the FCC's *Local Telephone Competition Report*, on which AT&T relies, significantly understates the amount of facilities-based competition, as measured by E-911 trunks or interconnection trunk ratios.[30] In

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27 AT&T Comments at 11-12. The post-1996 citations to Commission decisions, which AT&T glosses over, do not support the proposition that control of local access facilities will lead to anti-competitive conduct affecting long distance competitors. Rather, the Commission's more recent decisions state that BOCs' local facilities "could" raise competitive issues and "may" give BOCs an incentive to discriminate. *See id.* at 12-13, citing *LEC Classification Order and Non-Accounting Safeguards Order*.

28 AT&T Comments at 15-17, 19-22.

29 *Id*. at 21.

30 UNE Fact Report, Prepared for and Submitted by BellSouth, SBC, Qwest, and Verizon, CC Docket Nos. 01-338, 96-98, and 98-147, April 2002, App. A. (continued…)

fact, CLECs serve somewhere on the order of 20% of the access lines in BOC regions and as much as one-third of all business lines.[31] These data also fail to take into account growing wireless substitution and other sources of intermodal competition.[32] Intermodal competition, moreover, is expected to increase dramatically in the near-term, as cable operators deploy VoIP technology, which they will use to offer voice services in combination with high-speed Internet access and video services.

("2002 UNE Fact Report"). Indeed, the FCC itself has noted, "the reports of at least some CLECs are not consistent" with Commission directions, and, as a result, "there may be some need for further clarification and adjustment of the reporting system. *FCC Local Competition Report,* Feb. 2002 ed. at 1-2, n. 3.

31 *Id.* at I-6.

32 AT&T purports to dismiss wireless competition on the ground that "[m]ost consumer and business end-users who subscribe to wireless service also subscribe to wireline service." AT&T Comments at 24. That, of course, is a red herring. Irrespective of whether most consumers abandon their wireline connections altogether when they obtain wireless service (and some do), it is undeniable that wireless substitution, as well as intermodal competition from other sources, is one of the reasons LECs have experienced quarter over quarter declines in access lines and revenues. *See,* J. Hall, "Telecoms' Results Mixed, Competition Up," *Reuters* (July 24, 2003) http://biz.yahoo.com/rb/030724/telecoms_earns_1.html (reporting that SBC's second quarter revenues core local phone revenues fell 10.8% and that access lines in service dropped 4.2% and noting "local carriers have been hurt by weak demand as customers shift to wireless phones and e-mail, reducing the number of phone access lines in service.") *See also* K. Talley, "AT&T's Shares Advance 2.4% But Most Blue Chips Turn Tail, *The Wall Street Journal Online* (July 24, 2003) http://www.quicken.com/investments/news/story/?story=NewsStory/WSJ/20030724/SB105905442459400200.var&p=SBC ("Dow industrial SBC Communications …reported a 22% decline in net income from the second quarter of last year, as competition and consumers' preference for other technologies continued to erode access lines.").

AT&T also dismisses UNE-based competition on the ground that the availability and pricing of UNEs is "the subject of considerable controversy."[33] But there is no real controversy at this time as to the availability of the one facility that AT&T claims is a natural monopoly and on which it singularly focuses in its comments – DS0 loops. Unbundled DS0 loops will continue to be available to AT&T and others at least until the next Triennial Review proceeding is completed. To be sure, the Commission may – and should – revise its pricing rules, which today result in confiscatorily low UNE rates that permit CLECs to obtain substantial margins on no investment. Contrary to what AT&T claims, however, more rational and sustainable UNE pricing rules should lend stability to the UNE regime.

AT&T's distortion of local and access competition is particularly glaring when it comes to special access services. Its and others' arguments that the vast majority of buildings even in large cities are not currently served by competitive access providers ignore two critical facts.[34] First, a building does not have to be on a CLECs network for special access prices to reflect the competition provided by CLECs. Once fiber is laid in the ground nearby, the CLEC can add a particular building to its network at relatively low cost.

Second, competitive access facilities are not needed everywhere to bring about meaningful competition in special access services. Even if competitive

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33 Selwyn Decl. at ¶ 18.

34 *E.g.*, AT&T Comments at 19-22; Sprint Comments at 6-8.

facilities are not yet deployed in a particular area or along a particular route, it is beyond dispute that the special access market as a whole is subject to significant competition. BOCs and ILECs cannot ignore this competition, even where alternative facilities are not yet deployed, because customers (like AT&T) purchase special access on terms and conditions that apply to their entire networks. Moreover, the Commission's rules require a BOC or ILEC to make special access services available to similarly situated customers throughout its service area (throughout the MSA in areas where pricing flexibility has been granted, and throughout the service territory where it is subject to price caps). Consequently, competition in the most densely populated areas and along the most lucrative routes drives competition throughout. Thus, AT&T's claims that the "vast majority" of buildings are not currently served by competitive fiber is entirely beside the point.[35]

Moreover, competitors can meet the vast majority of the demand for special access services by locating facilities where businesses are concentrated. For example, 80 percent of SBC's special access revenues are derived from 25 percent of the wire centers in which it provides special access.[36] Consequently, through

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35 In any event, while claiming that the "vast majority" of commercial buildings are not currently served by competitive fiber, AT&T neglects to mention that most commercial buildings are tenanted by small businesses that have no need for, and thus do not purchase, special access services. AT&T's claims thus are not only irrelevant, but also patently disingenuous.

36 2002 UNE Fact Report at III-8.

targeted investment, competitors cost-effectively could extend their existing fiber facilities to buildings housing customers accounting for 97 percent of all special access revenues,[37] or virtually all of the customers that demand special access services.

And competitors are doing exactly that.

- According to data submitted to the Commission in connection with the Triennial Review, 532 carriers provided competitive access services,[38] and these competitors accounted for between 28 and 39 percent of all special access revenues.[39]

- There are at least 1800 CLEC fiber networks in the 150 largest MSAs, which contain 70 percent of the U.S. population.[40]

- 91 of the top 100 MSAs are served by at least 3 CLEC fiber networks, 77 of the top 100 are served by at least 7 networks, and 59 are served by at least 10.[41]

- At least one CLEC has fiber-based collocation in BOC wire centers containing 54 percent of the business lines and 44 percent of all access lines; many of those wire centers are served by multiple CLECS.[42]

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37 Declaration of Robert W. Crandall, attached to the Reply Comments of USTA, at 7, in *Implementation* of *the Local Competition Provisions of the Telecommunications Act* of *1996,* CC Docket No. 96-98 (April 30, 2001).

38 FCC, Telecommunications Provider Locator at Table 1 (November 2001).

39 2002 UNE Fact Report at III-8. Although, according to ALTS, the number of CLECs has declined, "the CLECs that remain have steadily increased their customers and revenue." ALTS, The State of Local Competition 2003, at 8 (April 2003). Indeed, total revenue for facilities-based CLECs was higher in 2002 than in any previous year, as was their market shares. *Id.* Thus, the competitive significance of CLECs has not decreased in any way.

40 2002 UNE Fact Report at III-7.

41 *Id.*

42 *Id.* at III-2.

- Competitive carriers have deployed at least 184,000 route miles of fiber.[43] CLECs have connected this fiber to at least 30,000 unique office buildings, and likely many more.[44] According to a coalition of which AT&T was a part, buildings accounting for "roughly one third of the 60 million or so business lines in the country" are directly connected to competitive fiber.[45]

- Despite the economic downturn, CLECs also have continued to receive funding to build out their networks. Last November, ALTS reported that "CLECs have collectively acquired over $1 billion in additional funding in the last nine months."[46]

- AT&T itself continues to expand its integrated local and long distance services to business customers where it can self-provide access. As it stated in a recent press release, "AT&T offers business local service in the 67 metropolitan areas where 70 percent of the nation's business customers are located. And the company now is aggressively leveraging its combined local presence and networking expertise to deliver fully integrated, end-to-

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43 *Id.* at III-6. ALTS claims the actual number is 339,501 (ALTS 2002 Local Competition Report at 17), which is comparable to the total route miles of fiber that AT&T has attributed to ILECs nationwide. (AT&T Comments in CC Docket No. 01-338, at 123 (estimating ILEC fiber transport networks at 362,000 miles).) Thus, according to their own trade association, CLECs have deployed almost as much competitive fiber as there is ILEC fiber.

44 Joint Comments of Allegiance Telecom, Inc. and Focal Communications Corp. at 25, and Comments of WorldCom, Inc. at 7, both filed in CC Docket 96-98 (June 11, 2001). As discussed in the 2002 UNE Fact Report, most CLECs do not report how many buildings their fiber networks serve. However, publicly available data for about 20 CLECs shows that they operate networks that serve approximately 330,000 buildings, which includes buildings served in part using facilities leased or resold from another carrier - including the ILEC. 2002 USTA Fact Report at IV-4.

45 Rebuttal Report Regarding Competition for Special Access Service, High-Capacity Loops, and Interoffice Transport, at 11, CC Docket No 96-98 (FCC filed June 25, 2001) (quoting Smart Buildings Policy Project, Meet the Coalition, at http://www.buildingconnections.org/pages/coalition.html).

46 ALTS 2002 Progress Report at 5. ALTS recently reported that "[d]espite the reduced availability of new funding, CLECs continue to invest in new facilities . . . ." ALTS, The State of Local Competition 2003, at 10.

> end networking solutions to the largest companies - the cornerstone of AT&T Chairman and CEO Dave Dorman's business strategy."[47]

Competition in local and access services, particularly special access, is robust.

2. BOCs Do Not Have The Ability To Exercise Any Claimed Market Power in Access Services In Any Event Because Those Services Are Subject to Rate Regulation.

Wholly apart from this competition, BOCs and ILECs could not raise access services in an anticompetitive manner because those prices are regulated. As then Judge Breyer wrote, "antitrust analysis must sensitively 'recognize and reflect the distinctive economic and legal setting' of the regulated industry to which it applies."[48] That is true not only for an antitrust analysis, but also for the competition analysis the Commission is performing here.

Switched Access. At both the federal and state levels, switched access services are subject to regulation. Therefore, BOCs and ILECs do not have any ability to raise access prices in pursuit of an anticompetitive agenda (even if they had such an agenda). To the extent long distance carriers claim otherwise, their claims are frivolous.

AT&T nevertheless claims that switched access prices already are at supracompetitive levels. It claims that the Commission concluded in *Intercarrier*

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47 AT&T Press Release, "AT&T Introduces New Business Local Access Offer For Large Companies, Government Agencies" (April 16, 2003).

48 *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991), quoting Watson & Brunner, *Monopolization by Regulated "Monopolies": The Search for Substantive Standards*, 22 Antitrust Bull. 559, 565 (1997).

Compensation for ISP-Bound Traffic that the TELRIC cost of delivering a call to an ISP is $.007/minute and that the $.055/minute rate established in the *CALLS O*rder is 700% above that level.[49] But, wholly apart from whether a rate in excess of TELRIC is "supracompetitive" – a dubious proposition at best – the $.007/minute rate established in the *Intercarrier Compensation Order* was not a TELRIC rate. To the contrary, that rate was part of an interim regime the purpose of which was to "begin[] a transition toward what we have tentatively concluded, in the companion NPRM, to be a more rational cost recovery mechanism *under which LECs recover more of their costs from their own customers."*[50] It was based, not on an approximation of TELRIC costs, but on: (1) the FCC's desire to "produce meaningful reductions" in intercarrier payments for ISP-bound traffic; (2) evidence that CLECs were using new types of switches, in particular, soft switches, to serve ISPs at a fraction of the cost of traditional circuit switches; and (3) reciprocal compensation rates that some BOCs and CLECs had negotiated in order to mitigate the regulatory uncertainty that existed while issues relating to reciprocal compensation for ISP traffic remained unresolved.

In the Order in which the Commission *did* address the issue of whether switched access rates are above cost, it held that they were not. Specifically, in the

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49 Selwyn Decl. at ¶ 44.

50 *Intercarrier Compensation for ISP-Bound Traffic,* CC Docket No. 99-68, Order on Remand and Report and Order, 16 FCC Rcd. 9151, ¶ 82 (2001) (emphasis added).

CALLS Order, while adopting an access reform plan proposed by AT&T and others which substantially reduced switched access rates, the Commission found that the target rates were "within the range of estimated economic costs of switched access that have been presented to the Commission."[51]

AT&T also maintains that intrastate switched access rates are above the economic cost of access. Focusing on a handful of states with the highest rates, and ignoring those states with lower rates, AT&T paints a distorted picture of intrastate access as a whole. In any event, to the extent intrastate access charges remain above economic cost in some states, it is only because state legislatures or state regulators continue to use access revenues to subsidize basic local exchange service. Those rates do not overcompensate BOCs and ILECs, as AT&T claims; they simply compensate them for more than one service.

Special Access. BOC and ILEC interstate special access rates are also subject to regulation. Those rates must be within price caps unless the BOC or ILEC has demonstrated to the Commission that sufficient facilities-based competition exists to prevent the BOC or ILEC from exercising market power (*i.e.*,

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[51] *In the Matter of Access Charge Reform*, 15 FCC Rcd. 12,962, 13,035-36, ¶ 176 (2000). SBC believes that ARMIS data are not a reliable basis upon which to calculate a rate of return for a specific service or class of services. Nevertheless, AT&T has relied on ARMIS data to claim that special access returns, and hence rates, are excessive. What AT&T does not tell the Commission is that, according to ARMIS data, SBC's rate of return for switched access was 1.4% in 2001 and 0.9% in 2002. Thus according to the ARMIS data on which AT&T relies, switched access rates are too low, not too high.

profitably raising and sustaining prices above competitive levels). Indeed, the major long distance carriers are among the largest facilities-based competitors to BOCs and ILECs for special access.

AT&T and others argue that BOC rates for special access have increased in areas where BOCs have been given pricing flexibility and that this supposed fact establishes that BOCs have market power in special access.[52] Of course, a price increase in the absence of regulation does not necessarily mean that the new price is not a competitive one; regulation may have held prices below competitive levels. A price increase also may reflect increases in demand, before supply and demand become equilibrated. Indeed, between 1996 and 2001, BOC special access lines grew 30 percent per year, on average, due to the rapid expansion of data services.[53] In such a dynamically growing market, a price increase says nothing about whether a firm possesses market power.[54]

In any event, marketplace evidence refutes AT&T's claims that the BOCs have exploited pricing flexibility solely to raise rates. Where it has obtained pricing flexibility, SBC has negotiated or proposed 60 pricing flexibility contracts, and filed

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52 AT&T Comments at 4; MCI Comments at 17.

53 *See* Declaration of Alfred E. Kahn and William E. Taylor On Behalf of BellSouth Corp., Qwest Corp., SBC Communications Inc., and Verizon, at 7-9, Attachment A to Opposition of SBC Communications Inc., RM 10593 (Dec. 2, 2002) ("Kahn and Taylor Decl."). That Declaration and Opposition identify many other critical flaws in AT&T's arguments that BOC special access rates are excessive. Rather than repeat them all here, SBC incorporates the Declaration and Opposition herein by reference.

19 contract tariffs,[55] that offer significant discounts off standard tariffed rates for special access services, and these offers are available to all similarly situated customers. For example, it has signed and filed with the Commission a contract tariff in the former Ameritech region that provides a 23% discount off SBC's tariffed rates for SONET services.[56] And it has signed and filed similar pricing flexibility contracts in the former Pacific Bell territory that provide discounts of more than 50% off SBC's tariffed rates for similar services.[57] SBC also has proposed numerous contract tariffs that would have provided customers significant discounts (between 10 and 25%) off the tariffed rate for a variety special access services, but lost the bids to other service providers. In each of those cases, the customer turned to a competing provider (or deployed its own facilities), confirming the Commission's predictive judgment about competition in pricing flexibility areas.

AT&T's argument is particularly disingenuous given that SBC also has sought to negotiate discounted contract tariffs that meet AT&T's specific needs. For example, SBC has met repeatedly with AT&T to discuss AT&T's existing and future network requirements, and to propose various options for meeting those needs more

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54 *Id.*

55 Most of these contract tariffs were filed in more than one of SBC's operating territories, and therefore are embodied in more than 19 tariff filings.

56 Ameritech Operating Companies Tariff F.C.C. No. 2, Section 22-13.

57 Pacific Bell Telephone Company Tariff F.C.C. No. 1, Sections 33-17 and 33-18. While these contracts have been with some of SBC's largest customers, SBC also has negotiated contract tariffs that provide almost 10% off the monthly tariffed rate with much smaller customers.

efficiently and at reduced rates. For example, in June 2002 and January 2003, SBC suggested that AT&T reconfigure its entrance facilities from DS-3s to dedicated SONET facilities, which would have saved AT&T 50 to 66 percent under SBC's existing tariffs, without the need for a pricing flexibility contract. SBC also has solicited AT&T's input in developing new products and services to satisfy AT&T's needs. While SBC has not yet signed a pricing flexibility contract with AT&T, it is not because of SBC's intransigence, but rather because of competitive alternatives available to AT&T.

To be sure, the BOCs have not reduced basic schedule, month-to-month special access rates in pricing flexibility areas to the levels that would have been dictated by continued application of the "x factor." But at the same time, BOCs have introduced a variety of pricing plans that offer significant discounts off basic schedule, month-to-month rates in return for volume and term commitments.[58] For example, SBC offers on average, across its regions, a 50% discount off the standard, month-to-month rate for DS1 services for customers committing to purchase service under a 5-year term plan. Customers purchasing under SBC's optional MVP tariff can obtain, on average, an additional 9-14% discount, and, under SBC's recently

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[58] SBC's pricing for these and other special access services is no different from volume and term plans introduced by wireless and long distance carriers, and thus simply reflects a growing trend in the telecommunications industry, rather than an exercise of market power as AT&T claims. Indeed, AT&T itself repeatedly has increased its basic schedule rates for long distance services, while offering lower rates for promotions and other discount plans.
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introduced Vista plan, can obtain additional discounts (up to 23.5% in SBC's Southwestern region) for purchases that exceed a customer's commitments under the MVP plan.[59] Indeed, contrary to AT&T's claim of massive rate increases for special access services in recent years, BOC special access revenue per special access line has been flat in nominal terms, and ***decreased*** 3 percent per year in constant dollars over the past several years.[60]

Nevertheless, using ARMIS data for 2001, AT&T asserts that BOCs' rates of return on special access services are excessive and demonstrate that BOCs have unconstrained market power in special access.[61] Yet, as AT&T well knows, accounting data do not reflect an economically accurate allocation of joint and common costs between the different services BOCs offer and the different jurisdictions they serve, because that allocation is inherently arbitrary. Thus, a rate of return for a single type of service calculated on the basis of accounting data is misleading.[62] Indeed, as noted above, the ARMIS data used by AT&T to calculate

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Nevertheless, SBC doubts that AT&T would concede that it has market power for such services.

59 AT&T qualifies for and obtains the highest discounts offered by SBC, while SBC's long distance affiliate receives much lower discounts (and thus pays more for special access services than AT&T).

60 Kahn and Taylor Decl. at 15.

61 AT&T Comments at 31. *See also* Ad Hoc Comments at 11-12.

62 *See* Kahn and Taylor Decl. at 7-9.

the rate of return on special access would show that SBC's rate of return on interstate switched access was 1.4% in 2001,[63] and 0.9% in 2002.

The Commission and AT&T have recognized the problems with calculating a rate of return for a single service based on accounting data. The Commission has found such rates of return to be so meaningless that it requires price-cap LECs to report rate-of-return information only on total interstate earnings, rather than based on individual baskets or service categories.[64] AT&T itself has acknowledged that calculating rates of return for individual services is meaningless. In seeking elimination of rate-of-return regulation for intrastate services in Massachusetts, AT&T argued that "determining a cost basis for calculating an economically meaningful rate of return is impossible" because AT&T "used the same network, computers, and other facilities" to provide multiple, multi-jurisdictional services."[65]

B. BOCs Cannot Acquire Market Power Through a Price Squeeze.

Our competitors' major argument is that BOCs and ILECs will acquire market power by implementing a price squeeze. They contend that BOCs may charge end-users less for long distance service than they charge other long distance

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63 Opposition of SBC Communications Inc., *supra*, at 22.

64 *See Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd. 2637, 2677-80 (1991), *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, 6833 (1990).

65 Kahn and Taylor Declaration, *supra*, at 8, quoting Initial Brief of AT&T Communications of New England, Inc., Mass DPU Case No. 92-79, at 42-43 (dated April 23, 1992).

carriers for access.[66] Moreover, they contend, charging access rates that are above cost is a price squeeze because it effectively allows a BOC to charge its competitors more for access than it charges itself.[67] These arguments are factually, legally and economically wrong.

As a fundamental matter, arguments that BOCs (or ILECs) can engage in a price squeeze are dependent on five critical assumptions. First, BOCs and ILECs have the ability to exercise market power in the pricing of access services. Second, BOCs and ILECs will be able to force all of their significant competitors out of the market (so that BOCs and ILECs can recoup their investment in low long distance prices by increasing their long distance prices). Third, BOCs and ILECs will keep both their current competitors and new entrants out of the market, notwithstanding the enormous amount of sunk investment in long distance facilities. Fourth, intermodal competition (*e.g.,* wireless, VoIP, other Internet applications such as e-mail and instant messaging) will be insufficient to keep BOCs and ILECs from charging supracompetitive prices for long distance. And fifth, regulators will stand by and allow BOCs and ILECs to charge supracompetitive long distance prices without imposing price controls. The Commission has repeatedly found that these

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66 *E.g.,* AT&T Comments at 26-27.

67 *E.g.,* MCI Comments at 16-18.

As demonstrated above, the Commission has concluded that interstate switched access services are not above economic cost. And special access rates affect only the provision of long distance services to large businesses, a

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or similar assumptions are unrealistic,[68] and there is no basis in the record here to conclude otherwise.

1. The Commenters Do Not Address – And Fail To Prove – The Elements Of A Price Squeeze.

As the U.S. Supreme Court and the Commission itself have recognized, allegations of predatory pricing (such as a predatory price squeeze) are often made by competitors who seek to use competition law as a shield to protect themselves against the lower prices offered by a more efficient competitor.[69] Courts and this

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very competitive segments of the marketplace in which BOCs generally have been far less successful.

68 *See Ameritech/SBC Order*, ¶¶ 231-35 ("price squeeze tactics are likely to fail under the circumstances presented here as a predatory tactic aimed at eliminating competition among interexchange competitors"). *See also NYNEX/Bell Atlantic Corp.*, ¶ 117 (1997) (same); *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Common Line Charges*, 12 FCC Rcd. 15,982, 16,100-04, ¶¶ 275-82 (1997) ("[c]urrent conditions in markets for interexchange services give us comfort that an anticompetitive price squeeze is unlikely to occur . . .") ("*1997 Access Charge Reform Order*").

69 In *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, the Supreme Court explained the inherent self-interest and danger of predatory pricing claims:

> [P]etitioners' competitors, seek to hold petitioners liable for damages caused by the alleged conspiracy to cut prices. . . . But cutting prices in order to increase business often is the very essence of competition. Thus, mistaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect.

475 U.S. 574, 594 (1986). *See also Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 116 (1986) ("[C]ompetition for increased market share, is not activity forbidden by the antitrust laws. It is simply, as petitioners claim, vigorous competition. To hold that the antitrust laws protect competitors

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Commission, therefore, should carefully and critically evaluate these claims to make sure that, if accepted, they would not harm consumers by causing higher prices.

In that regard, it is important to recognize what a price squeeze is and what it is not, and what the underlying competitive concern really is. Prohibitions against a price squeeze are not intended to guarantee competitors a profit regardless of their costs. They are designed to protect competition, not competitors. As then Judge Breyer wrote concerning an alleged price squeeze:

> [A] practice is not "anticompetitive" simply because it harms competitors. After all, almost all business activity, desirable and undesirable alike, seeks to advance a firm's fortunes at the expense of its competitors. Rather, a practice is "anticompetitive" only if it harms the competitive process. . . . It harms the competitive process when it

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from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share.").

Likewise, the Commission has stated that: "Price reductions are ordinarily good for consumers, though not pleasing to competitors. Predatory pricing, though often alleged, is generally uncommon, and proven cases are rare." *Policy and Rules Concerning Rates for Dominant Carriers*, 4 FCC Rcd. 2873, 3114 ¶ 499 (1989) (internal citations omitted). *See also PanAmSat Corp. v. COMSAT Corp. -- COMSAT World Systems*, 12 FCC Rcd. 6952, 6960 n.60 (1997) ("Low prices that are above cost are procompetitive. A less than stringent requirement of proof of below-cost pricing would run the risk of chilling beneficial price competition." (citing *Matsushita*, 475 U.S. at 594)); *Comsat Corp., Policies and Rules for Alternative Incentive Based Regulation of Comsat Corporation*, 14 FCC Rcd. 3065, 3077 ¶ 33 (1999) ("Without such an expectation of recoupment, the courts found that 'predatory pricing' actually benefits competition by lowering prices in the marketplace. It is for these reasons the Commission has also been skeptical of predatory pricing claims in the domestic local exchange market, even where carrier market shares exceed 95%." (internal citations omitted)).

> obstructs the achievement of competition's basic goals – lower prices, better products, and more efficient production methods.[70]

Thus, competition is not harmed if less efficient firms cannot compete successfully. Prohibitions against a price squeeze are aimed at assuring only that firms with a lower or equal cost of production are given a fair opportunity to compete for consumers' dollars. Because of the potential misuse of price squeeze allegations, it is critical that any such allegations be judged against the essential elements set forth in competition law.

A price squeeze occurs when "(1) the firm that is conducting the squeeze has monopoly power at the first industry level, (2) its price at this level is 'higher than a "fair price,"' and (3) its price at the second level is so low that competitors cannot match the price and still make a 'living profit,"' thereby ensuring that ***it will achieve monopoly power at the second level as well***."[71] In other words, this pricing is not anticompetitive or illegal, unless it creates monopoly power. Commenters alleging a price squeeze have not even attempted to demonstrate that the elimination of structural separation requirements makes each of these elements likely.

First, as demonstrated above, BOCs and ILECs do not have the ability to exercise monopoly power at the first industry level – the access level. Access rates

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70 *Id.* at 21-22 (internal citations omitted) (emphasis added).

71 *Town of Concord v. Boston Edison Co., supra,* 915 F.2d at 18 (Bryer, J.), *cert. denied*, 499 U.S. 931 (1991), *quoting U.S. v. Aluminum Co. of Am.*, 148 F.2d 416, 437-38 (2d Cir. 1945) (emphasis added).

at both the federal and state levels are controlled by regulation. Interstate special access rates are freed from regulation only if this Commission concludes that there is sufficient facilities-based competition to eliminate monopoly power.

Second, there has been no showing that access prices are "higher than a fair price." Certainly, given the statutory obligation of this Commission and the statutes governing State Commissions, which use various means, including price caps, to assure that rates for telecommunications services are just and reasonable, there can be no ***presumption*** that prices regulators either set or permit (pursuant to a price cap) are not fair. Commenters bear a heavy evidentiary burden that they have not even attempted to carry.[72]

Third, there has been no showing that equally efficient competitors cannot match BOC long distance pricing and still make a "living profit." AT&T is the only commenter that attempts to make a specific showing that BOCs are engaged in a price squeeze between access and retail long distance prices, and its argument is, on its face, both insufficient and self-contradictory. Moreover, absent from AT&T's analysis is any discussion of the prices incumbent long distance carriers are

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[72] As discussed above, to the extent, AT&T or others complain that intrastate access charges are unfair because they are above cost, AT&T ignores the fact that some states have chosen to use access to offset below-cost rates for local service. Unless and until the universal service provisions of the Communications Act are completely implemented by the States, BOCs and ILECs cannot reduce intrastate access charges and recover the costs of providing local exchange service.

themselves introducing, such as MCI's $39.99 offering of the Neighborhood in California.

According to AT&T, a price squeeze occurs when access rates are raised and competing long distance carriers must either raise their rates to maintain their profit margins, or reduce their rates to maintain their market shares, which will reduce their profit margins.[73] In claiming that the BOCs are engaged in a price squeeze, though, AT&T does not allege that it cannot earn a profit; it alleges only that it will make a smaller profit. Reduced profit margins, of course, do not force a rational competitor to exit a market. Thus, AT&T alleges that BOC provision of long distance service results only in meaningful competition, not a monopolistic price squeeze.[74]

AT&T also says that, in evaluating whether a price squeeze is taking place, one cannot look at interstate interLATA services alone, but must also consider intrastate interLATA services as well, since consumers are not able to pick different interstate and intrastate interLATA toll providers.[75] As discussed in the Reply Declaration of Drs. Carlton, Sider, and Shampine, AT&T is correct in that regard. Per minute access charges for intrastate long distance calls that are near or above rates for intrastate switched access are not evidence of a price squeeze. Among other things, the costs of minimum or fixed monthly charges for long distance

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73 AT&T Comments at 30-31.

74 *See* Carlton/Sider/Shampine Reply Decl. at ¶ 44, n.26.

service must be considered, as must the relevant costs and rates for other services bundled together with intrastate long distance. At a minimum, interstate and international long distance must be included.[76]

Yet, AT&T forgets its own position. The only evidence it presents of a price squeeze focuses ***exclusively*** on intrastate interLATA costs and prices in three of the fifty states and totally ignores interstate (and international) interLATA costs and prices![77]

2. Even If Access Prices Were "Above Cost," Those Prices Do Not Give BOCs and ILECs An Incentive To Engage In A Price Squeeze.

Some commenters argue that if access prices are above economic cost, BOCs and ILECs have the incentive to engage in a price squeeze because what the BOC or ILEC loses at the long distance level it can make in profits at the access level.[78] As demonstrated in the Reply Declaration of Drs. Carlton, Sider and Shampine, this argument is flawed as a matter of basic economic logic.

This argument fails because it ignores the critical fact that BOCs and ILECs actually ***lose*** access revenue when they provide long distance services. When a BOC or ILEC provides long distance services to a customer, it gains retail revenue but loses the access revenue paid to it by the customer's previous long distance

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75 AT&T Comments at 23.

76 Carlton/Sider/Shampine Reply Decl. at ¶¶ 18-27.

77 AT&T Comments at 27-30.

78 AT&T Comments at 26-27; MCI Comments at 16-17.

service provider.[79] This loss of access revenue to BOCs and ILECs – characterized as a lost "opportunity cost" – renders the BOCs' and ILECs' effective margin the same as other long distance carriers (assuming retail prices are the same).[80] Even if a BOC or ILEC were to price long distance services below access charges and earn a positive accounting margin (revenue less costs, exclusive of lost access fees), it still must bear the cost of both lost retail revenue ***and*** lost access fees.[81] Thus, there is simply no economic incentive to engage in a price squeeze, even if access charges were to exceed economic cost, because BOCs and ILECs will still lose the access revenue.

3. Even if BOCs or ILECs Were Able to Effectuate A Price Squeeze, They Could Not Obtain Market Power in Long Distance Services.

Even if a price squeeze were a real-world possibility, BOCs and ILECs would not be able to obtain market power in long distance services. As the Commission has repeatedly found, there is no reason to believe that any provider of long distance services could drive all other providers from the market.[82] That is no less true today than it was before.[83] Moreover, as the Commission has also found and economic logic dictates, BOCs would not be able to keep new entrants out if they

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79 Carlton/Sider/Shampine Reply Decl. at ¶ 6.

80 *Id*. at ¶ 7.

81 *Id*. at ¶ 8.

82 *See Ameritech/SBC Order* ¶¶ 212, 231-35; *NYNEX/Bell Atlantic Order* ¶ 117; *LEC Classification Order* ¶ 129.

83 Carlton/Sider/Shampine Reply Decl. at ¶ 16.

sought to recoup their investment in low prices by raising prices later because barriers to entry are low.[84] If current market participants were to exit and BOCs and ILECs raised long distance prices above competitive levels, the significant amount of sunk investment in long distance facilities means that existing facilities would be readily available to new entrants who would drive prices back down.[85]

And, even if all of that were not true, those raising price squeeze arguments have not shown that intermodal competition is not sufficient to discipline long distance prices. AT&T disingenuously seeks to dismiss the competitive significance of wireless services by saying that only a relatively small percentage of people have replaced their wireline phones with wireless phones.[86] Yet, this contention, which is beside the point even as to local services, does not address the issue of whether long distance prices charged by wireline providers are constrained by wireless services. As set forth in our initial comments, AT&T has repeatedly told the investment community that it is losing long distance business to wireless carriers.[87] It thus well knows that wireless services constrain the pricing of wireline long-distance services.

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84 *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, 13 FCC Rcd. 18,025, ¶¶ 36, 51 (1998) ("*WorldCom/MCI*").

85 Carlton/Sider/Shampine Reply Decl. at ¶ 16; Carlton/Sider/Shampine Decl. at ¶ 55-56.

86 AT&T Comments at 16.

87 SBC Comments at 18-19.

Moreover, as set forth in our initial comments, there are other sources of intermodal competition, including VoIP and other Internet applications (including e-mail and instant messaging) that increasingly will constrain long distance prices.[88] Surely any BOC or ILEC that was assessing its ability to recoup in the distant future reduced profits (or losses) incurred in the near-term would have to consider the implications of these emerging technologies and the cost savings they offer to the competitors who will rely on them. For this reason as well, no BOC or ILEC will be able to count on recoupment, and, hence, none would rationally pursue a policy that requires recoupment to be successful.

4. The Emergence of Bundled Service Offerings Does Not Make Price Squeezes More Likely.

Some commenters allege that the offering of bundled service offerings increases the likelihood of a price squeeze because it makes a price squeeze more difficult to detect.[89] But they do not explain how a BOC or ILEC could successfully execute a price squeeze – in a bundle or otherwise – given the unlikelihood that it would be able to recoup its investment in lower prices and profits by being able to charge supracompetitive prices later. The Commission previously has found that a successful predatory strategy is most unlikely in long distance services.[90] The

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88 *Id*. at 2-3, 20.

89 Sprint Comments at 5; Sage Comments at 8, 35.

90 *See, e.g., Ameritech/SBC Order* ¶ 231; *LEC Classification Order* ¶¶ 107, 129.

likelihood is no greater when providers bundle long distance service with other services.

As stated in the attached Reply Declaration of Drs. Carlton, Sider, and Shampine, "The fact that services are bundled does not alter the fact that a predatory price squeeze would require driving rival long-distance firms from the market and subsequently raising price."[91] The high sunk costs of providing facilities-based long distance service mean that even if current wireline competitors were forced out of the market, the resources that would remain in the marketplace are sufficient to permit easy entry by new firms or reentry by current market participants. Recoupment, therefore, is highly unlikely,[92] and it is only getting lower as intermodal competition becomes more significant.

The prices of bundled service offerings are also constrained by the prices of the separate services within the bundle. If consumers can buy the elements of the bundle from other competitors, those competitors' prices limit the ability of the seller of a bundled service offering to increase its price, even if the elements of the bundle are only available from different competitors.

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91 Carlton/Sider/Shampine Reply Decl. at ¶ 33.

92 *Id.*

5. Even If The Price Squeeze Allegations Had Merit, Dominant Carrier Regulation Is Not Necessary, Nor Would It Be Useful, To Address Them.

The Commission has recognized that the likelihood of a successful price squeeze – and therefore the incentive to enter into one – is remote. But, even if there were some realistic basis for this concern, it would not be addressed by dominant carrier regulation.[93] There are several reasons for this conclusion.

First and foremost, the elements of a price squeeze can be determined by competitors, and remedied by regulators or courts, without dominant carrier regulation of long distance services. Dominant carrier regulation of long distance services has no effect on the ability of competitors and regulators to assess whether access prices are conducive to a price squeeze. Nor does it have any effect on their ability to determine whether the "spread" between access prices and long distance prices is sufficient to allow other equally efficient carriers an opportunity to earn a living profit. The relevant data for this determination are the level of access prices (which competitors know both because access services are tariffed and because they are paying those prices); the level of long distance prices charged by the access provider (which competitors know because, among other things, the Commission

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[93] AT&T alleges that elimination of separate subsidiary requirements increases a BOC's incentives and ability to engage in a price squeeze (AT&T Comments at 45-46), but it offers no support for this bald assertion and it is economically illogical. A change in intracorporate organization does not change marketplace facts, and as demonstrated in this section of the comments, elimination of structural separation does not make it more likely that BOCs could or would engage in an undetected price squeeze.

requires this information to be publicly available[94] and because rivals monitor each others' prices as part of their competitive intelligence gathering processes); and whether the difference is sufficient to allow other equally efficient carriers an opportunity to earn a living profit. The last item can be estimated by a competitor's examination of its own costs and a general assessment of a BOC's or ILEC's likely costs.

Second, the sunset of structural separation requirements does not change the analysis. BOC long distance affiliates today are treated as nondominant, but that has not stopped AT&T from repeatedly raising price squeeze and predatory pricing allegations based on public information concerning BOC access charges and retail long distance rates.[95] Indeed, AT&T's comments, though analytically flawed, make clear that AT&T is privy to all the information it needs to identify a potential price squeeze. That will continue.

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94 47 C.F.R. § 42.10.

95 In Texas, AT&T was perfectly able and willing to prosecute its claim until the Texas PUC properly decided that whether AT&T and other significant long distance carriers would be forced from the market or whether AT&T's margins were sufficient to allow it to continue to compete were relevant issues. Rather than face discovery on the likelihood that it would exit the market and its profit margins, AT&T chose to amend its complaint and delete the predatory pricing allegations. *Complaint of AT&T Communications of Texas, L.P. Against Southwestern Bell Telephone Co. et al.*, Texas PUC Docket No. 23063, AT&T Motion for Leave to Amend Amended Complaint (Dec. 5, 2001) (dismissing predatory pricing and price squeeze allegations); Supplemental Preliminary Order at 10 (element of price squeeze is that "the competitor [AT&T] cannot profitably compete with the affiliated company [SBC Long Distance] in the downstream [long distance services] market") (Nov. 20, 2001).

Third, as the Commission has recognized, the imposition of dominant carrier regulation would have significant anticompetitive effects.[96] Indeed, to the extent bundled service offerings become more popular, the anticompetitive impact of dominant carrier regulation grows commensurately. AT&T's own comments make that eminently clear. AT&T sends a clear signal that if BOC bundled packages are treated as dominant, AT&T will pull out all stops to bog down every competitive offering in inquiries regarding, among other things, allocation of joint and common costs, and the reasonableness of projections of different customers' relative usage of the various components of the package. While it is undoubtedly true that a determination as to whether a bundled package is cost-based is more complex than a similar determination for a stand-alone service, that is all the more reason why that inquiry should ***not*** be conducted in the tariff review process. Given that the risk of a predatory pricing is remote at best, tariffing requirements – and the regulatory morass that those requirements would entail if AT&T has its way – would be overkill to the nth degree. There is no reason why whatever minimal risk there could be of predatory pricing cannot be addressed in the context of a complaint or antitrust action.

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96 *See LEC Classification Order* ¶¶ 85, 87, 90-91; *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 11 FCC Rcd. 20,730 ¶ 53 (1996).

C. BOCs Cannot Acquire Market Power Through Non-Price Discrimination.

AT&T and others further allege that BOCs are engaged in various forms of non-price discrimination,[97] but these assertions are no more availing.[98]

1. Competitors Have Not Shown That Widespread Discrimination Sufficient to Give BOCs and ILECs Market Power in Long Distance Services Is Feasible.

As set forth in our initial comments and the Declaration of Drs. Carlton. Sider, and Shampine, an argument that BOCs will be able to attain market power through non-price discrimination is simply not credible.[99] The reality is that BOCs and ILECs have been providing nondiscriminatory access service for almost two decades. They have automated systems and processes that are designed specifically to provide nondiscriminatory access service. Moreover, their long distance competitors routinely monitor the quality of the access services they receive. No one explains exactly how, in this context, discrimination could or would take place.

But even assuming *arguendo* that discrimination could take place in isolated instances, no one explains how an BOC or ILEC could discriminate in ways that would be evident to consumers and would cause them to alter their purchasing decisions, but would simultaneously be invisible to competitors and regulators. Indeed, it would not be enough for the BOC or ILEC simply to impair the quality of

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97 AT&T Comments at 45, 70; MCI Comments at 20-24.

98 *See* Carlton/Sider/Shampine Reply Decl. at ¶ 4.

99 SBC Comments at 42-43; Carlton/Sider/Shampine Decl. at ¶¶ 46-50.

its access service to a competitor; it would have to do so in ways that would induce disgruntled consumers to switch to its long distance service and not one of the other myriad of intermodal or intramodal suppliers. That result would require even more heavy-handed discrimination, and the notion that such discrimination could take place without detection defies imagination. Finally, this "now you see it; now they don't" trick would have to be performed over a long enough period of time so as to allow a BOC or ILEC to obtain market power in long distance services, and competitors and regulators would have to stand by and let this happen. The story is simply fantasy.

Contrary to the claims of AT&T and WorldCom, the story is no less fantastical in the absence of structural separation or in the context of bundled service packages. There is simply no reason to assume that the elimination of structural separation requirements will make any discrimination more difficult to detect or otherwise increase a BOC's ability to discriminate successfully. Like price squeezes, discrimination can be detected just as easily in the absence of structural separation as with it. CLECs and long distance carriers have demonstrated their ability to raise discrimination concerns with regulators. They will continue to have that ability by comparing various measures of how their orders are processed with how BOCs handle their own orders.[100]

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100 For this reason, there is no need for special safeguards addressing "grooming" of circuits. *See* MCI Comments at 26.

Nor, despite the contrary claims of Sprint and WorldCom,[101] does the offering of bundles of services by a BOC (as opposed to a BOC and its affiliate) change the analysis. Again, no evidence is presented that discrimination in the provision of access or related services to carrier-competitors is more likely to occur or more difficult to detect when BOCs bundle services other than access (long distance and local exchange service) to different customers (*i.e.*, end-users). A CLEC or long distance carrier can compare a BOC's provision of services to it with industry standards and a BOC's provision of services to itself. Whether a BOC sells retail services to end users separately or in bundles neither reveals nor hides the manner in which it provides inputs to those services to its competitors and itself.

2. Dominant Carrier Regulation is not an Appropriate or Effective Way to Prevent Discrimination in any Event.

In the *LEC Classification Order,* the Commission held that "for purposes of determining whether the BOC interLATA affiliates should be classified as dominant … we need to consider only whether a BOC could discriminate against its affiliate's interLATA competitors to such an extent that the affiliate would gain the ability to raise prices by restricting its own output upon entry or shortly thereafter."[102] Applying that reasoning here, dominant carrier regulation would be appropriate only if, upon sunset of the Section 272 structural separation requirements or shortly thereafter, a BOC could discriminate against its

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101 Sprint Comments at 5; MCI Comments at 6, 18.

102 *LEC Classification Order*, ¶ 111.

competitors to such an extent that it would gain the ability to raise prices by restricting its own output. As we showed above, that is not a realistic possibility. Thus, even if the Commission assumed that ***some*** discrimination could occur, dominant carrier regulation would ***not*** be an appropriate remedy to address that risk.

Indeed, claims to the contrary by AT&T and others ring hollow. The only purpose of dominant carrier regulation as a response to the risk of discrimination is to prevent rates that are too high.[103] That is not a risk that the Commission must address now (or likely ever), and any claims to the contrary are disingenuous. The goal of BOCs' competitors is to insulate themselves from competition by preventing the BOCs from offering discounts. The Commission should not allow them to attain that goal.

D. BOCs Cannot Acquire Market Power Through Cost Shifting.

Our competitors make two types of cost-shifting arguments and both should be rejected. Their arguments reveal only that they want the Commission to protect them from the competitive process and penalize efficiencies.

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103 *See* Carlton/Sider/Shampine Decl. at ¶¶ 70-71. As Drs. Carlton, Sider, and Shampine conclude at ¶ 46 of their Reply Declaration, "Dominant carrier regulation simply does not address the competitive concerns raised by AT&T . . . ."

1. Cost Shifting That Would Not Result in Market Power Does Not Justify Dominant Carrier Regulation.

Some commenters contend, often without any specifics, that BOC long distance affiliates are able to keep their prices low because some long distance costs are being shifted to, and recovered by, BOCs' local exchange service.[104] AT&T, for example, alleges that long distance affiliates are not paying for the full costs of marketing services and access to various databases.[105] The point these comments seek to make is that BOC long distance prices would be higher, and BOC local service prices would be lower, if each service were paying for its own costs. The Commission, they contend, should take action to require competition to be "equal."

AT&T is wrong both on the facts and the law. On the facts, AT&T's allegations that the BOCs and their long distance affiliates are engaged in cost shifting are unproven and untrue. BOCs are subject to stringent cost allocation and affiliate transaction requirements under Parts 32 and 64 of the Commission's rules, including annual audits to verify that costs have been allocated correctly. SBC's audits have never revealed evidence of non-compliance with the Commission's cost allocation rules.[106]

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104 AT&T Comments at 42; MCI Comments at 25.

105 AT&T Comments at 43-44.

106 To support its claims that SBC has engaged in cross subsidization, AT&T cites two California cases. AT&T Comments at 43-45. Both cites are grossly misleading. First, AT&T refers to an ALJ proposed decision in a case in which AT&T had taken issue with this Commission's interpretation of permissible joint marketing. AT&T neglects to mention that the ALJ's

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And on the law, the Commission has already concluded that cost shifting or misallocation on its own is no basis for imposing dominant carrier regulation. For dominant carrier regulation to be appropriate, cost shifting or misallocation would have to be so great as to convey market power on the BOCs and ILECs:

> For purposes of determining whether the BOC interLATA affiliates should be classified as dominant, however, we must consider only whether the BOCs could improperly allocate costs to such an extent that it would give the BOC interLATA affiliates … the ability to raise prices by restricting their own output. We conclude that, in reality, such a situation could occur only if a BOC's improper allocation enabled a BOC interLATA affiliate to set retail interLATA prices at predatory levels (i.e., below the costs incurred to provide those services), drive out its interLATA competitors, and then raise and sustain retail interLATA prices significantly above competitive levels.[107]

No commenter has shown that the Commission's prior analysis is wrong. Nor, of course, has any commenter shown that cost allocations are likely to restrict its output of services or result in predatory pricing. The market structure is such that BOCs simply are incapable of forcing all significant long distance competitors

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decision was never adopted by the California PUC, and, therefore, is of no moment. *See* Cal. Pub. Util. Code § 311(d) (Commission "may adopt, modify or set aside" ALJ proposed decision).

Second, AT&T refers to a biased audit report, that was conducted – not by the California PUC – but by a consultant to the Office of the Ratepayer Advocate. As SBC has stated in other proceedings, this report is defective because, *inter alia*, it was not conducted by certified accountants, was not in accordance with GAAP principles, and, in any event, has not been adopted by the California PUC. *See* Federal-State Joint Conference on Accounting Issues, Reply Comments of SBC Communications Inc., WC Docket 02-269, at 7-8 (Feb. 19, 2003).

107 *LEC Classification Order*, ¶103.

from the marketplace, and even if BOCs had that power, barriers to entry are sufficiently low that BOCs would not be able to raise and sustain retail long distance prices significantly above competitive levels.[108]

Indeed, most commenters (including WorldCom and Sprint) do not even attempt to show that alleged cost shifting could harm consumers of local or long distance services. As they must recognize (and as explained in the initial declaration of Drs. Carlton, Sider, and Shampine[109]), BOC local exchange and access services are regulated on the basis of price, not cost. Cost shifts or misallocations to local exchange or exchange access services, therefore, are irrelevant because they do not affect the prices consumers pay for those services. Because BOCs could not increase their revenues by shifting costs, there is simply no incentive for them to do so.[110]

2. Arguments Alleging Cost Shifting, If Accepted, Would Deprive Consumers Of The Benefits of Efficiencies.

AT&T and Americatel contend that BOC long distance services should not be priced on an incremental cost basis.[111] AT&T and its consultant contend that lower

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108 Carlton/Sider/Shampine Decl. at ¶¶ 54-57.

109 *Id.* at ¶¶ 64-66.

110 AT&T claims that cost shifting could be successful if legislators or regulators changed their price cap rules. (AT&T Comments at 61; Selwyn Decl. at ¶ 98.) Wholly apart from the fact that AT&T never addresses the other flaws in its argument (*e.g.,* how recoupment would be possible), AT&T's purely speculative argument is no basis upon which to impose the enormous burdens and social costs associated with dominant carrier regulation.

111 AT&T Comments at 46-47; Americatel Comments at 13.

long distance prices resulting from efficiencies generated by BOCs' offering of both local and long distance services is not what Congress had in mind and will ultimately result in less competition and higher prices.[112] Similarly, Americatel argues that BOCs should not be permitted to charge long distance rates that are less than the sum of (1) all of its incremental costs (including imputed access) and (2) an amount equal to the other costs the next most efficient provider would incur.[113] These arguments should be seen for what they are – an attempt to turn vigorous competition into a handicapped horserace in which more efficient competitors are burdened with additional weight.[114]

The Commission should be especially careful not to interfere with the ability of carriers to achieve efficiencies and pass those efficiencies on to consumers through lower prices. Competition law and sound regulation do not require that all competitors be guaranteed that market prices will be sufficient for them to recover

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112 Selwyn Decl. at ¶ 62.

113 Americatel Comments at 13 n.29.

114 Americatel also alleges that competition from BOCs in long distance services is inherently unfair because BOCs can use profits in one business to compete in a different line of business. Americatel Comments at 14-15 ("Other competitors . . . simply do not have the deep pockets of the BOCs.") This argument is without foundation and illogical. Surely there is no basis or precedent for stating that competition by a large or profitable firm is per se anticompetitive. An independent television station in the Washington market cannot successfully allege that having to compete against an NBC owned and operated station is impermissibly unfair simply because the local operations can receive financial support and programming from the network, or the network can be funded by profits from General Electric's other businesses.

their costs. If a firm can produce goods or services more efficiently, the fact that its competitors will lose customers (or even fail) reflects the competitive process at work.[115]

E. Other Arguments Are Misplaced.

Other issues raised by various commenters are misplaced, either because the issues have been raised and are being addressed in other dockets or because their arguments are critically flawed. In either event, the Commission should not accept them here.

1. PIC Administration.

Various parties argue that BOCs have an unfair advantage due to their role in PIC administration, including the process for imposing and lifting PIC freezes.[116] They contend that BOCs have an incentive to use the PIC process to favor their long distance operations and can do so by, for example, processing BOC affiliate PIC change requests more quickly and placing a freeze on the affiliate's long distance customers. They request that an independent administrator be selected to administer the PIC process.

The Commission has heard and rejected these or similar arguments previously, and there is no reason to revisit the issue here. First, there are already safeguards to address the potential problem. The Commission has said the various

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115 *Town of Concord, supra.*

116 AT&T Comments at 39-42; MCI Comments at 28-30; Working Assets Comments at 1, 6.

statutory provisions (such as Sections 201, 202, and 251) limit the ability of an ILEC to delay execution of carrier changes or otherwise use the PIC change process in an anticompetitive manner.[117] The Commission has also adopted rules to clarify the appropriate use of PIC freezes to avoid the possibility that they might be used in an anticompetitive manner.[118] Thus, if a BOC or ILEC misuses the PIC process, competitors already have an adequate remedy.

Second, the Commission has repeatedly rejected arguments for an independent third party to administer the slamming process, preferring instead to rely on federal and state oversight.[119] The request for a third party administrator of the PIC process should be rejected for the same reasons. The Commission and the States have been working together over the past few years to address these issues, and are in a better position than a third party administrator to handle these issues. Only the Commissions have the authority to provide consumers the "full panoply of relief options available under both state and federal law."[120] And the Commission

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117 *Implementation of the Subscriber Carrier Selection Changes Provisions of the Telecommunications Act of 1996; Policies and Rules Concerning Unauthorized Changes of Consumers Long Distance Carriers*, Second Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd. 1508, ¶ 103 (1998); stayed in part, *MCI WorldCom v. FCC*, No. 99-1125 (D.C. Cir. May 18, 1999); motion to dissolve stay granted, *MCI WorldCom v. FCC*, No. 99-1125 (D.C. Cir. June 27, 2000).

118 *Id.* at ¶¶ 115-20.

119 *Implementation of the Subscriber Carrier Selection Changes Provisions of the Telecommunications Act of 1996*, First Order on Reconsideration, 15 FCC Rcd. 8158 ¶¶ 22-23 (2000).

120 *Id.* at ¶ 25.

has told competing carriers that its complaint process is available if they have a valid complaint.[121]

2. Equal Access and Joint Marketing

WorldCom and others urge the Commission to change its interpretation of its equal access rules to restrict the extent to which a BOC can recommend its affiliate's (or its own) long distance services to its local exchange customers. For example, WorldCom wants the Commission to reject its prior decision that a BOC can market its affiliate's (or its own) long distance services to inbound callers ordering additional lines without informing them that they have a choice of long distance carriers.[122] This suggestion, too, should be rejected.

The equal access rules relating to marketing should be ***eliminated,*** not expanded. While it may have been appropriate in the years immediately following the Divestiture to regulate commercial speech to ensure that consumers were aware that they have a choice of long distance carriers, there no longer is any rational basis for such regulations. Consumers have been bombarded during the past nineteen years with television, radio, and newsprint advertising, direct mail

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121 *Implementation of the Subscriber Carrier Selection Changes Provisions of the Telecommunications Act of 1996*, *supra,* 14 FCC Rcd. 1508, ¶ 103.

122 MCI Comments, 26-27; Working Assets Comments at 4-5. The Commission, of course, has previously concluded that BOCs can engage in the same joint marketing efforts as any other carrier and declined to implement broader restrictions, such as those advocated here. *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd. 21,905 ¶¶ 288-93 (1996) ("*Non-Accounting Safeguards Order*").

solicitations, and telemarketing by the long distance industry. Rules that regulate commercial speech based on the notion that consumers must be informed that they have a choice of long distance carriers are completely anachronistic, unnecessary and, therefore, unconstitutional.[123]

3. Other Attempts to Rewrite Section 272.

Some commenters raise other arguments that are flatly contrary to Section 272 of the Communications Act. Z-Tel argues that the Commission should not allow Section 272(e)(4) to sunset.[124] The Commission, of course, has already concluded that the statute unambiguously provides that this provision does disappear when Section 272 sunsets if a BOC chooses to offer long distance services itself, rather than through an affiliate:

> We find that the plain language of the statute compels us to conclude that sections 272(e)(2) and 272(e)(4) can be applied to a BOC after sunset only if that BOC retains a separate affiliate. The nondiscrimination obligations imposed by subsections (e)(2) and (e)(4) are framed in reference to a BOC's treatment of its affiliates. In contrast, the nondiscrimination obligations imposed by subsections (e)(1) and (e)(3) are framed in reference to the BOC "itself" as well as the BOC affiliate. If a BOC does not maintain a separate affiliate, subsections (e)(2) and (e)(4) cannot be applied because there will be no frame of reference for the BOC's conduct.[125]

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123 Working Assets contends that BOCs get an unfair advantage from the use of information concerning customers' calling patterns, yet there is no allegation that BOCs are violating the FCC's rules on the use of CPNI. *See* Working Assets Comments at 4.

124 Z-Tel Comments, 2.

125 *Non-Accounting Safeguards Order*, ¶ 270.

Z-Tel criticizes this clear reading of the Act on the basis that Congress could not possibly have meant to allow BOCs to "opt-out" of such an important requirement.[126] But Z-Tel itself views Section 272(e)(4), which it asserts is critical, as merely duplicating the anti-discrimination provisions of Section 251(c)(3).[127] Additionally, Z-Tel ignores the fact that the non-discrimination and imputation requirements of Sections 272(e)(1) and (3) will continue to apply even after sunset. It claims that Section 272(e)(4) adds the requirement that "wholesale rates be 'properly allocated'" to BOC retail services,[128] but that argument misreads the clear language of the statute. Section 272(e)(4) says nothing about the allocation of ***rates***; rather it discusses the allocation of ***costs***.[129] Moreover, its contention that this section is critical is belied by its legislative history, as the Commission has recognized.[130]

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126 Z-Tel Comments at 8.

127 *Id.* at 7 ("Section 251(c)(3) similarly (and doubly) proscribes discrimination: it requires all ILECs to provide 'nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable and nondiscriminatory.'").

128 *Id.*

129 It provides that a BOC "may provide interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated." 47 U.S.C. § 272(e)(4).

130 *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, Second Order on Reconsideration, 12 FCC Rcd. 8653, ¶ 46 (1997) ("Congress did not appear to regard section 272(e)(4) as a particularly significant provision . . . .

(continued…)

Americatel contends that if BOC long distance services are to continue to be regulated as non-dominant, BOCs should be required to maintain a separate subsidiary for its long distance services and sell a minority interest in that subsidiary to independent shareholders.[131] This suggestion, of course, goes far beyond the balance Congress struck in Section 272. Congress clearly permitted the BOCs to offer in-region long distance services through a wholly-owned affiliate. Moreover, the requirement that those services be offered through an affiliate, rather than directly, sunsets after three years. The Commission, in the *LEC Classification Order*, properly found that BOC long distance affiliates would be regulated as non-dominant. The argument that, after sunset, BOCs should be required to retain a separate subsidiary and sell a minority interest in that company to retain non-dominant status in long distance services is flatly contrary to both the statute and the Commission's precedent, and must be rejected.

IV. Conclusion

For all of the reasons set forth above and in our initial comments, arguments that BOC and ILEC long distance services should be saddled with dominant carrier regulation (or any other regulatory requirements not imposed on other non-dominant long distance providers) should be rejected. After sunset of Section 272

Specifically, section 272(e)(4) was introduced as part of a lengthy managers' amendment to the Senate version of section 272. Significantly, the amendment as a whole was described merely as 'mak[ing] certain technical corrections.'").

131 Americatel Comments at 35.

structural separation requirements, BOCs and ILECs should be permitted to integrate their long distance operations and long distance services should be treated as non-dominant.

Respectfully submitted,

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July 28, 2003

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	)	**WC Docket No. 02-112**
2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules	)	**CC Docket No. 00-175**

REPLY DECLARATION OF DENNIS W. CARLTON, HAL SIDER AND ALLAN SHAMPINE

July 28, 2003

I. INTRODUCTION AND SUMMARY

1. We submitted a declaration in this matter on June 30, 2003 that presented the bases for our conclusion that elimination of structural separation requirements preventing ILECs from fully integrating their long-distance and local exchange operations will not adversely affect long-distance competition. Our analysis indicated that there is no economic basis for subjecting BOCs' in-region long-distance service to dominant carrier regulation following the sunset of Section 272 structural separation requirements, nor is there any economic basis for conditioning the non-dominant status of independent LECs' long-distance operations on the structural separation of those operations. Our June 30 declaration contains a summary of our qualifications.

2. At the request of counsel for Qwest, Verizon and SBC, we address certain points raised in comments submitted by other parties in this matter. Our reply focuses on comments by AT&T and the supporting affidavit by Dr. Lee L. Selwyn, which support the imposition of dominant carrier regulation on ILEC-provided long-distance services. Many of the points raised by AT&T and Dr. Selwyn are representative of issues raised in other parties' comments. We focus on issues they raise that were not directly addressed in our June 30 declaration. Our failure to discuss the remaining claims made by AT&T or Dr. Selwyn should not be interpreted to suggest that we agree with their analysis or conclusion.

3. The FCC's Further Notice of Proposed Rulemaking (FNPRM) asked whether elimination of structural separation requirements would be likely to: (i) facilitate non-price discrimination by ILECs against their long-distance rivals; (ii) facilitate a predatory price squeeze by ILECs against their long-distance rivals; and/or (iii) enable ILECs to shift costs from long-distance to local operations in a manner that would adversely affect long-distance

competition. The FNPRM also inquired whether dominant carrier regulation would address these potential concerns.

4. Our prior declaration described the conditions under which such strategies might succeed and showed that such conditions do not exist in the long-distance industry. AT&T and Dr. Selwyn have not shown otherwise.

- Successful non-price discrimination in degrading access to rival long-distance carriers requires both that ILECs' efforts not be detected by regulators and rival long-distance providers and that they be sufficient to induce consumers to switch to ILEC-provided services. AT&T and Dr. Selwyn fail to establish that (i) these unlikely circumstances both occur; (ii) elimination of structural separation requirements facilitates the pursuit of non-price discrimination by ILECs; and (iii) imposition of dominant firm regulation would be a necessary or appropriate way to address this risk.
- Successful pursuit by ILECs of a predatory price squeeze against rival long-distance providers would require that ILECs set long-distance prices at a sufficiently low rate and for a sufficiently long time to drive their rivals from the industry. Successful predation also requires that these rivals not reenter the industry (and that others not enter) since such entry would prevent ILECs from recouping their investment in predation through higher prices. Our prior declaration explained that successful predation is rare and AT&T and Dr. Selwyn fail to establish that there are any realistic predation concerns in the long-distance industry, especially given the ability of consumers to use wireless services to make long-distance calls, or other alternatives such as e-mail, instant messaging and voice over IP. They further fail to show that imposition of dominant carrier

regulation is a necessary or appropriate way of preventing such an unlikely occurrence.

- With respect to potential concerns that cost shifting by ILECs from unregulated to regulated activities could adversely affect long-distance competition, AT&T and Dr. Selwyn fail to establish that an ILEC's ability to predate depends in any way on its ability to shift costs. As discussed in our prior declaration, if an ILEC could predate – and there is no evidence suggesting that this is a realistic possibility – its ability to do so would not depend on its ability to shift costs. Neither do AT&T or Dr. Selwyn establish that (i) cost shifting that does not result in predation adversely affects long-distance competition in any way, or (ii) dominant firm regulation is a necessary or appropriate way of addressing the matter. As we discussed in our prior declaration, there is little if any incentive for integrated carriers to shift costs because regulated rates for local services are largely set independently of the costs reported by ILECs due to price caps and other forms of incentive regulation.

II. ILECS HAVE NO INCENTIVE TO SET LONG-RUN PRICES FOR LONG-DISTANCE SERVICES AT A LEVEL THAT DRIVES EFFICIENT RIVALS FROM THE INDUSTRY OR TO ENGAGE IN PREDATION

A. ILECS HAVE NO INCENTIVE TO SET LONG-RUN PRICES THAT RESULT IN THE EXIT OF EFFICIENT RIVALS EVEN IF ACCESS CHARGES EXCEED ILECS' COST OF PROVIDING ACCESS

5. AT&T's comments suggest that ILECs have a long-run incentive to set prices below competitive levels and, as a result, drive even efficient long-distance rivals from the long-distance industry. Its arguments focus on its claim that the cost to ILECs of providing access is

below the access charge to long-distance carriers.[1] This concern is further reflected in AT&T's longer-term policy goals, which are described in Section IV of its comments:

> There is a critical need for comprehensive intercarrier compensation reform in order to remove the BOC access cost advantage resulting from the current system of above-cost interstate and intrastate switched access rates, and to reduce the BOCs' ability and incentives to engage in anticompetitive price squeezes, and other anticompetitive cross-subsidization.[2]

6. There is no basis to AT&T's claim. AT&T ignores the fact that ILECs lose access revenue when they provide long-distance services. That is, when ILECs provide long-distance service they gain retail revenue but lose access revenue paid by a subscriber's prior long-distance carrier. The loss in access revenue is a real cost of providing retail long-distance service faced by ILECs which must be considered in any evaluation of the prices charged by ILECs as long-distance carriers.

7. For example, assume that the cost to an ILEC of providing access to long-distance carriers (including itself) is zero but long-distance carriers face access charges of $.01 per minute.[3] If an ILEC, rather than an independent long-distance carrier, provides long-distance service through its own affiliate at the retail price of $.05 per minute, it gains retail revenue of $.05 per minute but loses access revenue of $.01 per minute that it otherwise would have earned. In deciding whether to provide, and how to price, long-distance service, the ILEC must take into account the potential loss of access revenue. Any such loss in access revenues from long-

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1. For the purpose of this discussion, we assume that AT&T's claim that access charges are above ILECs' cost of providing access is correct and show that AT&T's argument fails nonetheless. Regardless of whether AT&T's assumption has merit, the fact that the Commission regulates access prices indicates that it believes that such regulation typically results in prices lower than would otherwise occur.
2. Comments of AT&T Corp., p.68 (hereafter, AT&T Comments).
3. We recognize that there is a cost of providing access, but for simplicity we assume zero cost in this example. The conclusions in this section are not altered if a non-zero cost is assumed.

distance carriers is a real cost (which economists call an "opportunity cost"). In our example, the ILEC would profitably provide long-distance service if the additional $.04 it earns by providing retail service (instead of access service alone) more than offsets the additional costs that it incurs in providing retail long-distance service. We refer to this $.04 as the "retail margin."

8. Thus, the access charge of $.01 represents a $.01 opportunity cost faced by the ILEC when it induces a long-distance customer to switch to its own long-distance service for a call. The effective margin earned by the ILEC in providing retail long-distance service (instead of access alone) is only $.04 per minute, the same net-of-access-cost margin the long-distance carrier earns (assuming it charges the same retail price). Thus, even if ILECs face costs of providing access that are less than the access charges paid by rival long-distance carriers, they have no long-run incentive to set price below $.05 per minute, the level implied by their opportunity cost of access and other relevant costs of efficiently providing long-distance service. At any lower price, ILECs would fail to earn a price that covers all their relevant costs.

9. This logic implies that ILECs will not have an incentive to provide long-distance service if rival carriers are more efficient. For example, assume that an efficient long-distance carrier requires a retail margin (retail long-distance price minus access charges) of $.04 to cover its relevant costs to provide long-distance service, while the ILEC requires a minimum retail margin of $.05 (ignoring the access charges) to provide long-distance service. (Recall that, for simplicity's sake, we assume above that ILECs can provide access at zero cost.) The ILEC's higher costs may, for example, reflect the fact that its network is less efficient than the networks of other long-distance carriers.[4] In this example, the long-distance carrier would, by assumption,

4. Betsy Barnard, President of AT&T noted, "'We have a significant advantage against any of the Bells… They don't have the assets, the networks, the services. It takes decades to build that capability." (Reinhardt Kraus, "Bernard Faces New Round of Challenges," Investor's

just cover its relevant costs of providing long-distance service (i.e., revenue of $.05 minus access charges of $.01 equals the required $.04 needed to cover relevant costs). The ILEC, however, would not cover its relevant costs including the opportunity cost of lost access fees if it provided the long-distance service instead (i.e., $.05 minus the opportunity cost of $.01 fails to cover the $.05 needed to cover the ILEC's relevant costs). Hence, the ILEC earns greater profits if its rivals provide long-distance service rather than itself (another way to establish this point is as follows: if rival long-distance carriers provide service, the ILEC earns $.01 in access charges, while if the ILEC provides the long-distance service itself, it earns nothing). As this example indicates, ILECs have no incentive to set the long-run price of long-distance service below the level implied by access charges and a competitive retail margin, and thus no incentive to drive more efficient long-distance rivals from the industry. [5]

10. For simplicity, the above discussion does not account for the expansion in output expected if long-distance prices were to fall below $.05.[6] This simplification, however, does not alter the basic conclusion that ILECs have no incentive to lower long-distance prices below the long-run competitive level (i.e., the level at which revenues cover relevant costs) and drive more efficient rivals from the industry in order to provide long-distance themselves. To see this point, assume that long-distance is competitive (in the sense that retail prices exceed access costs by an

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(...continued)
Business Daily, July 21, 2003.)

5. Consumers would benefit if ILECs were to attempt to set prices below the long-run competitive level ($.05 per minute) as long as this investment could not be recouped by raising prices above the competitive level in the longer term. As discussed in our initial declaration and further below, it is highly unlikely that such recoupment would be possible in the long-distance industry.
6. The FCC raises this as a potential issue in its Opinion in the Matter of Regulating Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, 12 FCC Rcd 15,756 (1997), ¶127 (hereafter, LEC Non-Dominance Order).

amount sufficient to enable long-distance carriers to earn only a competitive rate of return). Under these circumstances, if a reduction in access charges (and thus a reduction in retail rates) generated higher total access revenues as a result of higher usage, then ILECs would be expected to voluntarily reduce access charges, regardless of whether they also offer long-distance services. Because the FCC and states generally regulate the price of access (except for special access in areas where there is facilities-based competition), and long-distance carriers advocate such regulation, the FCC and long-distance carriers must believe that ILECs would increase access rates in the absence of regulation. (That is, if ILECs were not constrained by regulation, their profit-maximizing strategy would be to increase access fees, not to decrease them.) If that is so, ILECs would lose money by decreasing the price of access. Thus, there is no reason to expect that ILECs would set long-run prices below the level implied by access charges plus a competitive retail margin in order to drive more efficient long-distance rivals from the industry, even if output would expand at prices below $.05.

11. As this indicates, AT&T and Dr. Selwyn have not correctly identified the costs faced by ILECs in providing retail long-distance service. ILECs have no incentive to lower the long-run prices of long-distance services below the level implied by access charges and a competitive retail margin in order to provide the services themselves. As such, the success of long-distance carriers and ILECs in providing long-distance service will depend on which is more efficient.

B. ILECS DO NOT HAVE THE INCENTIVE OR ABILITY TO ENGAGE IN A PREDATORY PRICE SQUEEZE, EVEN IF ACCESS CHARGES EXCEED ILECS' COSTS OF PROVIDING ACCESS

12. Based on the mischaracterization of the effective costs faced by ILECs in providing long-distance services described above, AT&T and Dr. Selwyn argue that ILECs have the incentive and ability to engage in predatory price squeezes by setting retail long-distance

prices at or near access charges faced by their long-distance rivals.[7] This argument has no merit since above-cost access prices do not facilitate predation and cost-based access prices do not (by themselves) preclude predation.

13. As suggested above, regulated prices that long-distance carriers pay to access ILEC networks are one determinant of the retail price of long-distance services. Higher access charges result in higher costs to long-distance carriers and higher opportunity costs to ILECs when providing retail long-distance services, and thus higher long-distance prices charged by both ILECs and their rival carriers.

14. The level of the access charges faced by non-ILECs for originating and terminating calls does not affect an ILEC's incentive or ability to engage in a predatory price squeeze.[8] A predatory price squeeze requires that the ILEC charge a price below its rivals' costs (which include both access charges and any other relevant costs an efficient long-distance provider would face in providing service). An ILEC that pursues a predatory price squeeze "invests" by setting retail long-distance prices at below-cost levels (where costs reflect both access charges and other costs of providing long-distance service). Its low retail prices result in both a reduction in the ILEC's retail revenues (from existing retail customers) and its access revenues from other long-distance carriers when customers switch from rivals' long-distance services to its own.

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7. As summarized in the AT&T Comments (pp. 30-31), "[t]he BOCs also are using their special access bottlenecks to price squeeze IXC competitors … by raising the price of special access services to all interexchange carriers, thus causing competing IXCs … 'to either raise their retail rates … or … reducing their profit margin'." Also see AT&T Comments (p. 26).
8. This discussion treats long-distance as a single service. In fact, long-distance includes a variety of services such as interstate and intrastate long-distance. As discussed below, predation requires that prices be set below relevant costs for all services taken as a whole in order to drive rivals from the industry.

15. The fact that an ILEC might appear still to earn a positive accounting margin (defined as revenue less costs, ignoring lost access fees) by setting price below access charges is not relevant for evaluating whether predation makes economic sense. Even if the ILEC earned a positive accounting margin during a predatory price squeeze, it still must bear the cost of lost retail revenue and access revenue. Any attempt to engage in a predatory price squeeze also would likely require that retail prices be set below the appropriate measure of costs for an extended period of time. This in turn suggests that the "victims" of this strategy would have the opportunity to pursue complaints about such conduct, which further reduces the likelihood that such efforts could succeed.

16. For an ILEC to recoup its investment in predation, it would have to raise retail prices above the preexisting levels after rivals are driven from the industry. As discussed in our prior declaration, it is highly unlikely that a long-distance carrier could recoup any investment in predation due to the difficulty of precluding competition if prices were to rise above preexisting levels.

- Provision of long-distance service involves extensive use of fixed assets that would remain in the industry even if a service carrier became bankrupt. These assets would be available (probably at a fraction of their original cost) to any entrant and/or to firms that would emerge from bankruptcy proceedings resulting from below-cost pricing, as would the human capital (the workers) formerly employed by the bankrupt firm.
- In addition, the widespread use of wireless services for long-distance calling (as well as e-mail as a substitute for certain long-distance calls) adversely affects an ILEC's ability to recoup an investment in predation by raising long-distance price

after driving its rivals from the industry because certain calls will be lost to these other modes of communication.

- Successful recoupment subsequent to predation would be easily detectable and would likely trigger a regulatory response.

17. In sum, the level of access charges is irrelevant to an ILEC's ability to pursue a predatory price squeeze. This strategy is deterred by the difficulty the ILEC would face in recouping its investment in predation, not by the relationship between access charges and access costs (even if parties could agree on the correct measure of cost).

C. PER MINUTE CHARGES FOR INTRASTATE LONG-DISTANCE CALLS NEAR OR BELOW ACCESS CHARGES ARE NOT EVIDENCE OF A PREDATORY PRICE SQUEEZE

18. AT&T and Dr. Selwyn claim that BOCs are currently engaging in predatory price squeezes against their long-distance rivals. For example, AT&T claims that "BOCs are engaging in price squeezes by setting their long-distance rates at or below their switched access prices."[9] Citing Dr. Selwyn's declaration, AT&T claims that BOCs offer long-distance calling plans at rates equal to or below intrastate access prices in Texas, Virginia and Washington.[10]

19. The examples presented by AT&T and Dr. Selwyn, however, do not support their claims that BOCs are engaging in predatory price squeezes against their long-distance rivals.[11] A predatory price squeeze drives rival long-distance suppliers out of business. But if rivals provide many services (such as interstate and intrastate long-distance), predation can succeed only if the target firms are driven from the industry (i.e., if their total revenue fails to cover the total non-

9. AT&T Comments, p. 26.
10. AT&T Comments, p. 27 citing Declaration of Lee L. Selwyn on behalf of AT&T, June 30, 2003, ¶¶43-48, 84-88, 96 (hereafter, Selwyn Declaration).
11. Curiously, Dr. Selwyn focuses on intrastate rates even though this inquiry deals with interstate rates.

sunk costs of long-distance service). More specifically, even if access prices exceed the per-minute component of price for some retail calls, this would not prove predation.

20. Long-distance services include a variety of types of calls including interstate/interLATA calls, intrastate/interLATA calls, and international calls to various destinations. Different types of calls may result in different costs to long-distance carriers. For example, access charges for intrastate calls vary across states and often differ from access charges for interstate calls. Long-distance carriers also may face higher costs for completing calls that travel longer distances.[12]

21. When firms offer a variety of diverse services, there are a variety of prices they can charge that enable them to cover costs. With respect to long-distance services, firms may well earn the same net-of-access-cost margin for interstate and intrastate calls (by charging different prices for these types of calls when access charges differ). Other carriers may choose to charge the same per-minute price for interstate and intrastate long-distance calls and earn different margins on each.

22. Presumably, long-distance carriers choose price schedules for different types of calls based on a variety of considerations including cost differences for different types of calls, the mix of calls made by their subscribers, and marketing considerations. For example, a long-distance carrier may determine that charging the same rate for interstate and intrastate long-distance calls may help attract customers.[13]

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12. For example, calls that cover longer distances occupy greater network capacity than calls that cover shorter distances.
13. We understand that if a company offers a plan that does not differentiate between interstate and intrastate long-distance, it is required to offer the same plan on the same terms in all states, even though intrastate access fees and other costs differ between states. Under Dr. Selwyn's theory, the company would be pricing predatorily if the per-minute charges were lower than the highest access cost in any state.

23. Under these circumstances it is not surprising that different firms adopt different pricing schedules. For example, some long-distance carriers charge the same per-minute rates for interstate and intrastate long-distance calls even when access fees differ.[14] Similarly, some plans charge more for calls that cover greater distance (within the U.S. mainland) while other plans do not.[15] The relevant question for evaluating predation, however, is whether revenue for all services taken as a whole exceeds the relevant costs in providing all services.

24. More generally, "below-cost" pricing for only one of multiple dimensions of service (e.g., intrastate long-distance calls in one state) does not imply that a firm is engaged in predation. Instead, predation requires first that prices be set at a sufficiently low level that rival firms are driven from the industry. This requires analysis of whether the revenue for all services taken as a whole exceeds the relevant costs incurred in providing those services. While Dr. Selwyn claims that per-minute charges below access rates for <u>intrastate</u> calls alone reflect an anticompetitive price squeeze, he is wrong. As he acknowledges in other parts of his analysis, it is inappropriate to consider interstate and intrastate interLATA calls as separate services.[16]

25. Similarly, since the mix of services consumed by different customers will vary, there may be differences in the profitability of serving different customers when the margins for each of the individual services in the package differ. However, the profitability of any given customer is not relevant for analyzing predation, which again requires that prices be set

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14. For example, AT&T's "One Rate USA" and "Unlimited" plans charge the same per-minute fees for intrastate and interstate calls, while its "5 cent nights" and "5 cent weekend" plans do not.
15. See, for example, Sprint's "Dial 1" and "The Most II" services.
16. Selwyn Declaration, pp. 37-38, states: "Customers cannot and do not make separate service provider selections *notwithstanding the fact that the two services are subject to different regulatory treatment by different regulatory authorities and may be offered at different prices."* (Emphasis in original.)

sufficiently low across a sufficiently broad range of customers that rival firms cannot cover their costs and are therefore driven from the industry.

26. Any evaluation of predation must also include fixed monthly charges (which are often accompanied by lower per-minute charges) that are a standard element in many long-distance pricing plans. Evaluation of an alleged predatory price squeeze must consider both aspects of pricing. For example, an ILEC could charge a fixed monthly charge with no per-minute charges for a fixed bundle of long-distance minutes.[17] If so, it would be inappropriate to conclude that the ILEC was engaged in a price squeeze simply because the per-minute aspect of price was zero and therefore below the per-minute access charge. However, this is precisely what would be implied by AT&T's and Dr. Selwyn's analysis. Instead, the presence of such a plan would more likely be an effort to offer a pricing package that would be attractive to a segment of (presumably high-use) subscribers.

27. Significantly, neither AT&T nor Dr. Selwyn has claimed or presented any evidence that ILECs' long-distance service taken as a whole (including interstate, intrastate and international services) is priced below cost. Given the lack of such evidence and the difficulty of recoupment, the AT&T claim that ILECs are now engaged in predatory price squeezes should be dismissed.

III. AT&T INCORRECTLY SUGGESTS THAT ILEC OFFERS OF LOCAL/LONG-DISTANCE SERVICE BUNDLES ADVERSELY AFFECT LONG-DISTANCE COMPETITION AND REQUIRE DOMINANT FIRM REGULATION

28. AT&T and Dr. Selwyn focus on recent marketing developments in the telecommunications industry to support their argument that ILECs' provision of long-distance services should be subject to dominant carrier regulation after sunset of structural separation

17. We understand that most carriers offer such plans.

rules. Bundled local/long-distance services have been introduced in recent months by both CLECs as well as ILECs (in certain states in which they are authorized to provide long-distance services). Bundled service offerings typically provide local service and a fixed (or even unlimited) number of long-distance minutes for a fixed monthly fee. For example, AT&T's "One Rate USA" plan and MCI's "Neighborhood Complete" plans provide unlimited local and long-distance calling as well as certain vertical services for $49.95 and $49.99 per month, respectively, in most states where they are offered. (MCI offers its "Neighborhood Complete" plan for $39.99 per month in California.) Verizon's "Freedom" plan offers these services for $59.95 per month.[18]

29. Generally, the success of bundled packages reflects the fact that some consumers find them attractive economic alternatives to non-bundled services and there is no basis to view them as anticompetitive devices. Indeed, CLECs themselves began offering bundled packages of local and long-distance service before the BOCs were legally able to do so. Moreover, CLECs continue to aggressively market such packages in the Ameritech region, where SBC has not yet received interLATA authority and thus cannot itself offer similar packages.

30. The FCC has previously recognized in other circumstances that bundled services can result in consumer benefits and that they carry low risk of anticompetitive behavior. In an order permitting ILECs to bundle local exchange service and CPE, the FCC concluded:

> [W]e conclude, in light of the existing circumstances in these markets, that the risk of anticompetitive behavior by the incumbent LEC in bundling CPE and local exchange service is low and is outweighed by the consumer benefits of allowing such bundling. We view the risk as low not only because of the economic difficulty that even dominant carriers face in attempting to link forcibly the

18. These rates may differ between states.

> purchase of one component to another, but also because of the safeguards that currently exist to protect against this behavior.[19]

31. Dr. Selwyn, however, argues that bundled service offerings "inextricably" link local exchange services and long-distance services, and because local exchange services are regulated this "requires that the BOC long-distance affiliates themselves be classified and regulated as dominant carriers."[20] He further argues that "only IXCs that bundle local and long-distance services together into the same package can compete" with ILEC bundled service offerings.

32. There is no basis for these claims. Bundled local/long-distance services offered by ILECs and CLECs compete not only with each other but also with local services and long-distance services offered on an unbundled basis and with bundled services offered by wireless carriers. The majority of subscribers still obtain local and long-distance services on an unbundled basis. Thus, the prices charged for bundled services are constrained by the prices of the component services. A consumer will choose the bundled service only if it is more attractive than purchases of the component services on an individual basis. Furthermore, since long-distance carriers were legally able to (and did) introduce local/long-distance bundles before BOCs did, it is difficult to see how they can now claim to be disadvantaged when BOCs respond with their own bundles, since, according to AT&T's logic, only BOCs that offer bundled services could compete with long-distance carriers' bundled service offerings.

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19. FCC, Policy and Rules Concerning the Interstate, Interexchange Marketplace, 23 CR 641, 16 FCC Rcd 7418 (2001), ¶33.
20. Selwyn Declaration, p. 47.

33. AT&T also asserts that (i) local/long-distance bundles facilitate ILECs' ability to engage in a predatory price squeeze; and that (ii) local/long-distance bundles facilitate anticompetitive cost shifting.[21] There is no basis for these claims.

- The fact that services are bundled does not alter the fact that a predatory price squeeze would require driving rival long-distance firms from the industry and subsequently raising price. For the reasons discussed in our prior declaration and above, it is highly unlikely that such a predatory strategy would succeed because of the difficulty of recoupment. Both the availability of wireless services (as well as e-mail and instant messaging which are substitutes for certain long-distance calls) and the difficulty of preventing reentry of existing rivals and entry of new firms make it highly unlikely that investments in predation could be recouped.
- The emergence of bundled service would not facilitate cost shifting that would result in predation. As discussed in our prior declaration, there is no basis to conclude that the ability to shift costs facilitates a predatory price squeeze. The fact that some consumers prefer bundles does not alter this conclusion. Moreover, as explained in our prior declaration, there is no basis to conclude that cost shifting would result in greater ILEC revenue for local service in the presence of price caps.

34. Given the benefits of bundles for consumers, the lack of incentive for ILECs to drive efficient long-distance rivals from the industry, and the difficulty of recouping any investment in predation, there is no basis to view bundles as anticompetitive. Under these

21. AT&T Comments, p. 65.

circumstances, the consequence of regulatory proceedings to determine whether tariffed rates for bundles cover relevant costs would be to chill competition and harm consumers.

IV. CHANGES IN LONG-DISTANCE SINCE 1997 PROVIDE NO SUPPORT FOR IMPOSITION OF DOMINANT CARRIER REGULATION ON ILEC LONG-DISTANCE SERVICES

35. In 1997, the FCC found that ILECs' long-distance affiliates should not be classified as dominant carriers simply because ILECs remained significant providers of local services. The Commission also concluded that dominant carrier regulation did not address the potential concerns arising from BOCs' integration in the provision of local and long-distance services, including non-price discrimination against rival long-distance carriers, predatory price squeezes, and cost shifting.[22]

36. AT&T now argues that the FCC's conclusions in its 1997 LEC Non-Dominance Order no longer apply due in part to changes in market circumstances, including weakened financial strength of rival long-distance carriers, which AT&T claims leaves them less able than the ILECs to provide bundled service offerings.[23] AT&T also claims that BOCs' success in obtaining wireline long-distance subscribers requires application of dominant carrier regulation. This section shows that there is no merit to either of these claims.

A. ILECS FACE INCREASED, NOT DECREASED, LONG-DISTANCE COMPETITION

37. As discussed in our prior declaration, ILECs face long-distance competition from a number of large national carriers that control vast networks, including several new fiber optic networks that did not exist in 1997. In our prior declaration, for example, we demonstrated that

22. LEC Non-Dominance Order, ¶¶6-7.
23. AT&T Comments, p.57.

the provision of wireline long-distance services is far less concentrated today than it was when AT&T was granted non-dominant carrier status.

38. Moreover, by a variety of measures, the broader telecommunications industry is also more competitive today than in 1997. For example, in recent years not only has the concentration of wireline long-distance services fallen, but new services, including wireless phones and Internet services, have achieved extraordinarily rapid increases in penetration. These new technologies have introduced significant new intermodal competition to the long-distance industry. As a result, wireline long-distance usage and prices have fallen substantially in recent years. While these events have led to weaker financial performance and even bankruptcies among some telecommunications carriers, such events are evidence of increased long-distance competition, not a diminution of competition.

39. AT&T suggests that financial weakness on the part of some companies may make them more vulnerable to predation. However, as we discussed in our prior declaration, even if a company goes bankrupt, its assets will remain in the industry, making recoupment of any investment in predation highly unlikely. Global Crossing, GST and others have been through bankruptcies with their assets remaining in the industry after having been purchased by others at a fraction of their original cost. The same will be true of MCI: either it will emerge from bankruptcy and compete, or its assets will be acquired and used by others to provide similar services.

B. BOCS' SUCCESS IN GAINING LONG-DISTANCE CUSTOMERS DOES NOT JUSTIFY IMPOSITION OF DOMINANT CARRIER REGULATION

40. AT&T and Dr. Selwyn suggest that BOCs' share of wireline long-distance subscribers provides further justification for imposition of dominant carrier regulation. However, their discussion fails to consider the increased intermodal competition from wireless

and Internet services. They also fail to note the rapid decline in the concentration of wireline services and the fact that BOCs' shares (in states where long-distance authority was granted nearly three years ago) are well below AT&T's at the time that it was declared to be a non-dominant carrier.

41. While AT&T and Dr. Selwyn suggest that BOCs' shares of long-distance will continue to increase, this assertion, even if true, is not necessarily indicative of market power. Indeed, AT&T itself has argued, and the Commission has found, that a high market share is not indicative of market power if elasticities of supply and demand are high. In any event, as discussed in our prior declaration, the share of BOC customers that take BOC-provided long-distance service grows rapidly for roughly two years after the BOC achieves long-distance authority in a state but generally stabilizes after that. That declaration showed that analysts also project that BOCs' share of long-distance subscribers will stabilize at levels far below those projected by AT&T and Dr. Selwyn.

42. AT&T and Dr. Selwyn attribute BOCs' success in gaining long-distance subscribers following authorization to provide these services to their "ability to exploit their inbound marketing channel and offer pricing plans ignoring the cost of access …"[24] They argue that these advantages allow BOCs to charge lower prices, which harm the long-distance carriers by taking large numbers of customers from them and forcing them to lower their own prices. However, AT&T confuses harm to competitors and harm to competition.

43. AT&T and Dr. Selwyn mischaracterize the costs faced by ILECs in providing long-distance service and mistake procompetitive efficiencies with anticompetitive behavior.

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24. Selwyn Declaration, pp. 52-53.

When providing their own long-distance services, ILECs lose access revenue previously earned from rival long-distance carriers. This reflects a real loss in revenue to ILECs that will be considered in any price determination by a profit-maximizing firm. Thus, it is simply incorrect for AT&T and Dr. Selwyn to claim that ILECs can "ignore the cost of access" in pricing long-distance services.

44. To the extent that ILECs have been successful in gaining long-distance customers due to their ability to market to their existing customer base, then this reflects a procompetitive efficiency. If firms that jointly market both local and long-distance service can realize lower costs of customer acquisition and marketing, then this reflects realization of economic efficiencies. While firms that are less efficient marketers may lose customers as a result, this reflects the results of the competitive process, not harm to competition.[25] Both the BOCs' and long-distance companies' experiences in introducing bundled services to the marketplace indicate that consumers often prefer the convenience of a bundled long-distance/local offering.

C. THE FCC'S 1997 CONCLUSION THAT DOMINANT CARRIER REGULATION WOULD NOT ADDRESS POTENTIAL COMPETITIVE CONCERNS REMAINS VALID

45. The FCC concluded in 1997 that dominant carrier regulation of BOC in-region affiliates "generally would not help to prevent improper allocations of costs, discrimination by the BOCs against rivals of their interLATA affiliates, or price squeezes…"[26] The FCC's decision

25. Dr. Selwyn complains that long-distance margins are being reduced. However, that is not the issue because competition reduces margins, which is beneficial to consumers. The issue here is whether margins are reduced to predatory levels (in the sense that positive margins would be eliminated).
26. FCC, LEC Non-Dominance Order, ¶6. The FCC notes in ¶111 of this Order that "For purposes of determining whether the BOC interLATA affiliates should be classified as dominant, however, we need to consider only whether a BOC could discriminate against its affiliate's interLATA competitors to such an extent that the affiliate would gain the ability to

holds true even after expiration of structural separation requirements. As discussed in our prior declaration, dominant carrier rules are generally designed to prevent price increases, not attempts to set below-cost prices. They do not affect the ability of consumers, rivals or regulators to detect non-price discrimination, and they do not address predation concerns.

46. Dominant carrier regulation simply does not address the competitive concerns raised by AT&T, including non-price discrimination, cost shifting and predatory price squeezes. AT&T also has presented no evidence that elimination of structural separation rules in related circumstances has resulted in competitive problems.

47. Nonetheless, AT&T argues that imposition of dominant carrier regulation on ILEC-provided long-distance services would impose little if any burden on ILECs.[27] However, AT&T and Dr. Selwyn fail to rebut the Commission's prior conclusion that dominant carrier regulation can adversely affect long-distance competition. As we discussed in our prior declaration, the FCC has found, correctly in our view, that dominant carrier regulations can deter competition by, among other things: discouraging the introduction of innovative new service offerings; reducing the ability of firms to engage in price competition, including offering secret discounts; limiting the ability of firms to rapidly respond to changes in market conditions; and deterring firms from developing customer-specific service offerings.[28]

(...continued)
raise prices by restricting its own output upon entry or shortly thereafter."
27. AT&T Comments, p. 73.
28. FCC, Policy and Rules Concerning the Interstate, Interexchange Marketplace, 11 FCC Rcd. 20, 730 at ¶23, 53.

V. RESPONSES TO ADDITIONAL POINTS RAISED BY AT&T

A. THERE IS NO BASIS FOR AT&T'S VIEW THAT ILEC PARTICIPATION IN ADJACENT MARKETS IS INHERENTLY ANTICOMPETITIVE

48. AT&T's comments suggest that ILEC provision of telecommunications services such as long-distance that rely on the local exchange is inherently anticompetitive. It argues that "ILEC control of the local bottleneck confers market power in all downstream markets."[29] We disagree.

49. As noted in our prior declaration, there is ample history that contradicts this blanket claim and shows that AT&T's claimed distrust of ILEC participation in downstream markets is unwarranted. The FCC has previously concluded that ILEC provision of a variety of ancillary services, including customer premises equipment (CPE), various enhanced services (such as voice mail), and information services did not adversely affect competition and further found that structural separation requirements were not necessary to preserve competition. When ILECs are efficient suppliers and their participation does not harm competition, restricting ILECs as competitors by subjecting them to dominant carrier regulation would only adversely affect competition.

50. AT&T's general condemnation of ILEC provision of non-local services also ignores the variety of other regulatory safeguards in place. As discussed in our prior declaration, ILECs have long been subject to nondiscrimination requirements in their provision of access services, and they have developed systems, procedures and processes to ensure that they comply with their nondiscrimination obligations. They also face established, sophisticated long-distance competitors who presumably monitor the quality of the access services they receive. The

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29. AT&T Comments, p. 18.

elimination of structural separation will not alter these realities, nor would dominant firm regulation address any perceived risk of increased discrimination. Nor, for that matter, does AT&T explain how ILECs could keep rivals from the market if they attempted to raise long-distance price and thus recoup investments in a predatory price squeeze. AT&T also fails to explain how ILECs would benefit from shifting costs from unregulated to regulated activities given the widespread reliance on price-cap regulation and establishment of interstate access fees based on factors other than ILECs' costs (through the CALLS order).

51. Thus, there is no basis for AT&T's suggestion that ILECs' provision of non-local services is inherently anticompetitive. Rather, the heightened competition in long-distance services that has resulted from BOC entry, experience in other markets that BOCs have been permitted to enter, such as CPE and enhanced services, and price regulation, where necessary, of access and local services provide ample evidence that ILECs' provision of non-local services benefits consumers and promotes competition.

B. DR. SELWYN INCORRECTLY SUGGESTS THAT STRUCTURAL SEPARATION REQUIRES THAT ILECS BE DENIED ANY ADVANTAGES OF VERTICAL INTEGRATION. HOWEVER, RESTRICTIONS ON ILEC ACTIVITIES CAN REDUCE THEIR EFFECTIVENESS AS SUPPLIERS OF NON-LOCAL SERVICES AND HARM CONSUMERS

52. Dr. Selwyn claims that the separate subsidiary requirements of Section 272 require affiliates to ignore any efficiencies from their affiliation with a BOC.[30] He claims that:

> [L]ower long distance prices arising solely or primarily from BOC exploitation of integration efficiencies and joint profit maximization is clearly not what Congress had in mind. … If the BOCs are the *only* downstream providers that are permitted

30. Selwyn states that Section 272 reflects "an attempt to force the affiliate (the provider of the downstream product) to set its retail prices so as to maximize its own profits, just as any non-affiliated IXC, which is operating in the (same) downstream product market, would be expected to do." (Selwyn Declaration, p. 62)

> to benefit from these types of integration efficiencies, then they will ultimately be the only downstream providers to survive in the retail long distance mass market. And that outcome is clearly *not* what Congress intended, and will surely result in less competition and higher prices overall.[31]

53. Dr. Selwyn's fear that ILECs will displace all other long-distance carriers appears to be based on his failure to consider the costs ILECs face in terms of foregone access revenue in providing long-distance services. When these costs are properly considered, there is no reason to conclude that ILECs' provision of local services gives them any inherent access cost advantage that would enable them to supplant all other competitors. The history of ILEC provision of long-distance services to date fails to support Dr. Selwyn's proposition.

54. While we offer no opinion on Congress' intent in drafting Section 272 of the 1996 Act, Dr. Selwyn's interpretation would be expected to result in significant consumer harm. As noted above, market activities by CLECs as well as ILECs indicate that many consumers prefer obtaining local and long-distance services from the same supplier. That is, it often is economically efficient to provide these services jointly. Dr. Selwyn's interpretation would surely interfere with ILECs' ability to exploit these and other potential efficiencies that ILECs could realize by integrating their local and long-distance operations.

VI. CONCLUSION

55. ILECs have no ability to engage in non-price discrimination against rival long-distance carriers, a predatory price squeeze against long-distance rivals or cost shifting that adversely affects long-distance competition, whether or not they offer long-distance services through a separate affiliate. Accordingly, there is no basis for imposing dominant carrier regulation on the ILECs' provision of in-region, interstate, interLATA services.

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31. Selwyn Declaration, p.63.

I declare under penalty of perjury that the foregoing is true and correct to the best of our knowledge and belief.

Dennis W. Carlton

Dennis W. Carlton

Hal Sider

Hal Sider

Allan Shampine

Allan Shampine

July 28, 2003